

Number **22**



Corporate Governance in Vietnam

The beginning of a long journey

 **IFC**
International
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World Bank Group

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Mekong Private Sector Development Facility

Number **22**

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Executive summary

The study looks at current corporate governance (CG) practices in a representative sample of large state-owned and private enterprises in Vietnam. The major objectives of the study were to: i) gain a better understanding of actual corporate governance practices in Vietnam; ii) provide inputs and recommendations for the drafting of the Enterprise Law 2005 and other elements of the legislative framework that governs business activity in Vietnam; and iii) identify regulatory and non-regulatory ways to improve corporate governance standards in Vietnam.

A sample of 85 relatively large firms in Vietnam across different legal forms and business sectors were surveyed. The survey questions were wide-ranging, and spanned issues relating to: i) their corporate governance structures; ii) their Boards of Management; iii) their Inspection Committees; iv) the rights and treatment of their shareholders; v) the roles and responsibilities of their senior management; vi) their disclosure and transparency issues; and vii) their perceptions of corporate governance in Vietnam. This report provides the main findings of the survey.

Formal compliance versus actual practice

In terms of documentation, most companies in Vietnam appear to comply with existing laws and regulations related to corporate governance issues, particularly those that apply to their company charters. However, there can be a distinct difference between technical, regulatory compliance and actual practice. The extent to which companies' actual corporate governance practices deviate from the letter and/or spirit of the law, suggests that current corporate governance documents are: i) not being drafted sufficiently well and ii) not being adequately implemented or enforced.

The role of the Inspection Committee is one example of the latter. It appears that in practice, many Inspection Committees in Vietnam lack adequate authority to perform their roles to the full extent. Indeed, the authority of the Inspection Committee appears to be one of the 'weakest links' in Vietnam's corporate governance 'chain', principally because its members are often subordinate to the company's senior management, and therefore lack sufficient confidence or authority to identify and challenge any malpractices that they may see occurring.

Weak internal corporate controls

Another weak link appears to be internal corporate controls that guard against: i) related party transactions that could be detrimental to the firm and its shareholders and ii) potential conflicts of interest for management. The majority of firms surveyed appear to have no written guidelines on either of these issues, and are therefore vulnerable to abuse. Even a cursory review of media reports on corporate governance malpractices in Vietnam suggests that a substantial proportion of these incidents arise as a complete or partial consequence of inadequate controls in these two specific areas. The problem seems particularly apparent in state-owned enterprises (SOEs), where the payment of 'commissions' is common and official salaries tend to be lower.

Differences according to company type

Evidence from the survey suggests that the general standard of corporate governance practices in equitized companies is better than in both their SOE and joint stock peers. The precise reasons for this are unclear, although it is probably a function of: i) the actual equitization process itself, which results in firms implementing a more robust corporate governance 'architecture' at the time of divestment by the government and/or ii) the wider shareholder base that most equitized companies tend to possess.

The concept of shareholder rights

The survey results suggest that the concept of shareholder rights has yet to take root fully in Vietnam, as there is a widespread perception that senior executives principally govern the direction of companies. Shareholder activism is rare, if not entirely nonexistent. This is due in part to: i) the relatively new notion of shareholding ownership in business and ii) the substantial degree of overlap between shareholders and management within most firms.

This is particularly apparent in the Board of Management, whose composition often more closely resembles that of a firm's senior management rather than its shareholder base (in cases where such a distinction can be made). Non-executive or independent members in Boards of Management remain a relative rarity. Such a state of affairs undermines the capacity of the Board to perform as a monitor of management actions, on behalf of all shareholders.

Lack of transparency and disclosure

The general transparency and disclosure standards of the firms surveyed were not particularly high, with just over half of firms not audited by an external auditor. A large proportion of firms surveyed believed it would be difficult to improve financial disclosure standards in Vietnam without an overhaul of the country's tax system and its administration.

Specific challenges facing State-owned enterprises

State-owned enterprises are confronted with a particular set of challenges in the broad field of corporate governance. These include: i) a lack of clarity in the roles and responsibilities of state agency officials who are mandated to represent the government as 'owner'; ii) the continuation of a quasi-administrative approach to the direction of SOEs, including the setting of operating targets and the continued practice of 'ask and give'; and iii) conflicts of interest that confront SOE managers. As a cumulative result, SOEs are often not able to perform in an optimal manner, their corporate governance practices can deviate away from best practice, and abuses of position can occur.

Support for improving corporate governance in Vietnam

The concept of corporate governance is not yet well established in Vietnam. Almost two-thirds of firms surveyed did not think that the current business environment was conducive to the pursuit of good corporate governance. Nonetheless, the majority of respondents surveyed thought that: i) corporate governance was an important issue and ii) the government should consider improving corporate governance practices a high priority. A clear majority thought that introducing a code or set of guidelines on corporate governance would be useful. Only a small minority thought that implementing good corporate governance practices would be a costly and/or time-consuming exercise.

The initiatives that firms thought would be most useful in improving corporate governance practices in Vietnam were: i) more training for Board of Management members and senior executives; ii) improved transparency through reform of the tax administration system; and iii) the government setting a good example through its own operations.

Recommendations

As requested, initial findings of the survey and recommendations were provided to the drafting team of new Enterprise Law, which was passed by National Assembly in November 2005. They included: i) specify greater disclosure requirements for Board of Management members and senior executives of firms; ii) provide more clarification on the concept of the 'fiduciary duty' of Board of Management members and senior executives of firms, so that they are cognizant of their roles and responsibilities; iii) strengthen the authority of Inspection Committees, so that they can better perform their assigned duties; iv) strengthen and better protect the rights - and equitable treatment - of shareholders, and particularly of minority shareholders; and v) have more stringent regulations to prevent related party transactions and avoid conflicts of interest. All of the recommendations were incorporated into the final law, some to a larger degree than others. The recommendations are still relevant, however, to other existing related laws or new laws and regulations, e.g. the securities law, pertaining to corporate governance.

In addition to regulatory measures, the following non-regulatory activities would be highly effective, and are therefore strongly recommended: i) a public awareness and education campaign to explain why the pursuit of better corporate governance practices can be of genuine and practical benefit to companies and shareholders; ii) advocacy work in promoting good corporate governance practices within the business community; iii) the provision of practical training on specific corporate governance themes and issues (e.g., auditing and accounting) for senior executives and members of Boards of Management and Inspection Committees; and iv) working with banks and credit scoring agencies that can promote better corporate governance practices while also providing better access to finance. All the above activities might best be done under a large scale corporate governance initiative with multiple aims, including awareness-raising, training, direct technical assistance, and capacity building for existing local institutions. In this context, the kind of approach taken by IFC's large-scale corporate governance technical assistance work in Eastern European transitional countries is worthy of consideration in Vietnam.

Introduction

CHAPTER 1

1. A corporate governance era

1.1 The concept of corporate governance

Concepts, definitions and perceptions of corporate governance tend to differ from country to country. Similarly, the internal organizational structures intended to safely direct and control activities within companies, and the laws and regulations that exist to police them, also differ from country to country. In Germany, for example, large public companies tend to have a two-tier board system, comprised of: i) a non-executive supervisory board which often includes employee representatives and ii) an executive board. This contrasts with the single board of directors system adopted in the US and UK, which has the primary role of protecting the shareholders' interests. However, one commonality in both systems is that such boards have a role and responsibility to oversee the actions of senior management, so as to ensure that the running of the company adheres to the wishes and interests of shareholders. This serves to provide a broad working definition of corporate governance: a "set of mechanisms by which a company is directed and controlled...[so as to]...protect the best interests and fair treatment of the shareholders..."¹ More specifically, corporate governance has been depicted as a means by which "outside investors protect themselves against fraudulent asset [and cash flow] diversion by... insiders."²

1.2 Why corporate governance matters

The potential for the personal interests of a company's senior managers to diverge from those of its shareholders is commonly referred to as 'agency theory'. Where the managers and the owners of a company differ, as they often do in larger firms with a wide shareholder base (such as one resulting from a public share offering and listing on a stock exchange), there is a possibility that their respective interests may become misaligned. This is where boards of directors and inspection/auditing committees can balance the

1 'Recommendations on Good Corporate Governance Practices in Vietnam', p. 1. This is broadly similar to the definition provided by the Cadbury Committee of 1992.

2 'Policies for Corporate Governance and Transparency in Emerging Markets', p. 9.

equation, monitoring the actions of senior management (who control the day-to-day operations of the company) on the shareholders' behalf.³ But there are also other stakeholders that can influence a company, including employees and unions, suppliers, clients, and the government.

For governments, the pursuit of good corporate governance practices primarily stems from a wish to improve business probity, and conversely, prevent corporate scandals or crises which could have an adverse - and potentially systemic - impact on the wider corporate sector, the financial sector, the investment community and products (including personal savings and pensions), and the economy as a whole. Put in a more positive light, if good corporate governance practices result in efficiency and productivity gains for individual companies and their investors, as described in the next paragraph, then their aggregate impact on the overall economy should also be beneficial.

There is clear evidence that the enactment of good corporate governance can have a real and positive impact on: i) a company's efficiency and operational performance; ii) its ability to access finance, particularly from investors and capital markets; iii) the reduction of risk related to its day-to-day operations; iv) its compliance with laws and regulations; and v) the degree to which it can protect itself from corrupt practices. The cumulative result can be "larger investment, higher growth, and greater employment creation."⁴ As a consequence, studies also show that investors are genuinely more willing to pay - and willing to pay more - for shares in companies that are perceived as conforming to higher corporate governance standards.⁵ Conversely, investors will pay less, or may simply choose not to invest at all, in firms that display poor corporate governance practices. Put another way, companies that adhere to higher standards of corporate governance tend to be rewarded with lower costs of capital and higher share price valuations.

Recognizing the importance of corporate governance, governments in numerous countries have issued mandatory rules and/or guidelines to specifically address this issue. International and multilateral agencies have produced documents and resources, including the OECD's 'Principles of Corporate Governance,' to assist in

3 In Vietnam, enterprises have Inspection Committees. According to the Enterprise Law 1999, the Inspection Committee is responsible for supervising all operations and business activities of the Company on behalf of the shareholders. The law also stipulates that an Inspection Committee is required for any company with more than 11 shareholders. In other countries there is often an Audit Committee, a Nominations Committee, and/or a Compensation Committee. These are usually chaired by independent directors.

4 'Corporate Governance and Development', p. 14.

5 For example, see studies by CLSA, McKinsey and the World Bank, profiled briefly in 'Recommendations on Good Corporate Governance Practices in Vietnam', p. 3.

these efforts.⁶ These policies and studies have, in turn, been based on a large body of empirical studies and analyses conducted over recent decades. However, although there is a relative wealth of literature on the topic of corporate governance, particularly pertaining to large, private firms in industrialized countries, there has been rather less analysis done on corporate governance in banks, family-owned firms and state-owned firms.⁷ As these two latter categories represent the large proportion of businesses in today's Vietnam (and most developing countries), the lack of specifically related research can pose a challenge for policymakers interested in identifying and applying appropriate recommendations and guidelines.

Scandals emanating from corporate governance malpractices and fraud, of one kind or another, litter the pages of history. A number of high profile cases have been particularly evident in the global press over the past few years, particularly since the pricking of the 'dot.com' bubble in the US in 2001. Company names that often come to mind include: Enron, Tyco International, Arthur Andersen, Daewoo, Adelphia Communications, Xerox, Global Crossing, Qwest, Shell, Ahold, Rite Aid, and AIG, among others. At the time of writing, the former CEO of US firm WorldCom, Bernie Ebbers, had recently been found guilty in a US\$11bn accounting fraud case dating from June 2002. The court's verdict came despite Ebbers' plea that he lacked the ability to spot the fraud, as he had no formal training in accounting. The jury deemed that this was not an adequate defense. Also, the high-profile trial of former Enron executives for fraud and conspiracy is currently underway.

In recent years Vietnam has also witnessed a number of company scandals stemming from corporate governance malpractices. They have included some of the largest corporate names in the country, including subsidiaries or affiliates of PetroVietnam (Petroleum Technical Service Company), Vietsovpetro, Petechim, Vietnam Airlines (Vinapco), Seaprodex, Incombank, Viet Hoa Bank, Saigon Beer, Minh Phung, and Epco. Collectively, these incidents underline the need for major improvements in corporate governance practices in Vietnam.

But these incidents alone, and a desire to avoid their repetition in the future, are not the only rationale for pursuing a good corporate governance program in Vietnam. The growth and development of the country's corporate sector will depend on the creation of more efficient and competitive business entities that can compete directly with their overseas peers, both for international markets and in an increasingly liberalized

6 A useful and fairly comprehensive guide to these can be found in 'Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook', pp. 34-38.

7 See 'Corporate Governance and Development', p. 1. A good review of the existing literature is provided by Pei Sai Fan.

domestic market. This, in turn, will largely rest on the creation of more robust, sustainable, and in most cases, larger corporate entities. Such a goal will be difficult to achieve without the introduction and implementation of good corporate governance practices that: i) permit investors and creditors to provide long-term capital to firms and fund investments with confidence; ii) enable senior managers to focus on generating efficiency and productivity gains; and iii) allow for the creation of an internal 'architecture' within firms that allows them to increase their scale and capacities.

In recent years, there has been a veritable explosion in the number of new companies being registered in Vietnam. But most are small, and the number of large, internationally competitive firms operating in Vietnam is not as high as many might think. Because the pursuit of good corporate governance practices will be an important element in developing the next generation of domestic firms capable of competing at home and overseas, it should comprise a central part of the ongoing economic reform and business liberalization process in Vietnam. While the following quote refers to China, it can apply equally to Vietnam:

"While establishing and strengthening the new mechanisms of corporate governance are necessary to realize and solidify the benefits of past reform efforts, they are also likely to prepare the ground for further progress in institutional transformation."⁸

2. Objectives of the study

Relatively little research work has been done in the area of corporate governance in Vietnam. As far as we are aware, the only specific corporate governance project to have been undertaken in Vietnam thus far is a project by Danida of Denmark. As part of its 'Support to Industry Restructuring & Enterprise Development' (SIRED) project, Danida seeks to strengthen corporate governance practices in the local fisheries sector. In addition to providing tailored assistance and training for Board of Management members, the project also aims to establish a 'Directors' Club' to serve as an informal working forum for directors and senior executives in Vietnam's fisheries sector.

However, as of yet, there has apparently been no empirical study of general corporate governance practices in Vietnam, and so this report reflects an attempt to fill, at least partially, the gap. Our study looks at current corporate governance practices in a

⁸ 'Corporate Governance and Enterprise Reform in China', p. 3.

representative sample of 85 large state-owned and private enterprises in Vietnam. Its major objectives are:

- To gain a better understanding of actual corporate governance practices in Vietnam, and potentially serve as a baseline study to measure future progress on good corporate governance practices in Vietnam.
- To provide inputs and recommendations for the drafting of the new Enterprise Law and for other elements of the legislative framework related to business activity in Vietnam. This study is, in part, a response to the Enterprise Law drafting team's request for insights on the actual corporate governance practices in Vietnam's companies and for guidance on this issue. Initial findings and recommendations of this survey were provided to the drafting team of the Enterprise Law, 2005.
- To identify ways to improve corporate governance standards in Vietnam, both through regulatory and non-regulatory means and initiatives.

Just as concepts, definitions and perceptions of corporate governance tend to differ from country to country, so too do corporate governance practices and efforts to improve good corporate governance standards. As one expert has noted:

"it is important to realize that enhancing corporate governance will remain very much a local effort. Country-specific circumstances and institutional features mean that global findings do not necessarily apply directly to each and every country and situation. Local data need to be used to make a convincing case for change."⁹

This is the primary rationale for this exploratory study.

We expect the survey results and recommendations to be of direct interest and relevance to: policymakers and relevant government agencies; managers and directors of both state-owned and private firms; members of the donor community who seek to support Vietnam's private sector development (including IFC-MPDF ourselves); and other parties with an interest in Vietnam's corporate community and business environment.

9 'Corporate Governance and Development', p. 32.

Survey methodology and sample profile

2 CHAPTER

1. A brief profile of Vietnam's corporate community

Before describing the methodological approach and sample profile in detail, this section first provides a brief profile of Vietnam's corporate sector. This is intended to provide some background context to the study's findings, and support the rationale behind the sampling method selected.

1.1 State-owned enterprises and equitization

The development of the corporate community in any country is an ongoing process. But this is particularly true in Vietnam, where an economic reform and business liberalization process, broadly underway since the mid-1980s, has caused a major change in the country's corporate sector profile. Once largely dominated by SOEs, since the mid-1990s, the corporate community has seen a burgeoning in the aggregate number and diversity of private firms. This has not only resulted from the equitization campaign, which has seen numerous former SOEs partially divested from state ownership, but also from the establishment of many private start-up ventures. A major milestone in this regard was the Enterprise Law of 1999, which significantly simplified the formal registration process for household enterprises and wholly new business entities. Since January 2000, when the Enterprise Law actually came into force, the number of new firm registrations has accelerated considerably.

As of 2003, Vietnam had around 4,800 SOEs; down from around 6,000 in the mid-1990s and around 12,000 or more in the mid-1980s. Official figures would lead us to believe that around 75% of existing SOEs are registering a profit. By no means are all SOEs large companies. Around 60% have equity valued at VND5bn or less. From 1992 through mid-2004, just over 1,400 SOEs had been equitized, with a further 800 or so either leased, sold, merged,

changed in legal status, deemed bankrupt, or liquidated. In 2003, a revised State Enterprise Law aimed at clarifying the state's management of SOEs was passed, heralding the establishment of a state investment corporation to hold and represent the government's stakes in enterprises.

As of late 2002, SOEs accounted for less than 9% of total company registrations in Vietnam, compared with 4% for foreign-invested firms and 87% for domestic non-state firms. However, SOEs accounted for slightly over 63% of total corporate capital, compared to 15% for domestic non-state firms and 22% for foreign-invested firms. Their relative under-performance is reflected in the fact that SOEs only generated about 51% of Vietnam's total net turnover, compared with 30% of turnover emanating from domestic non-state firms and 19% from foreign-invested projects. At the end of 2002, the average number of employees in a central SOE was just over 700, and just under 250 for a provincial SOE. The average fixed assets per employee of a central SOE was reported to be VND173m, and VND72m for a provincial SOE. The average turnover per employee was VND328m for a central SOE, and VND180m for a provincial SOE.

1.2 The private sector

Private and limited liability companies make up the large majority (around 86%) of domestic non-state companies, as measured by company registrations; the remainder are collectives and joint stock companies. In terms of capital, limited liability firms lead, followed by joint stock firms. Given their relative youth, it is perhaps not surprising to find that most domestic private firms are small, by whatever yardstick one chooses to use. In late 2002, there was less than 125 firms with more than 1,000 employees; compared with around 30,000 (54% of all non-state firms) with less than 10 employees. Similarly, there was less than 90 non-state firms with capital resources of more than VND200bn, according to official figures; compared with over 48,000 firms (87% of all non-state firms) with VND5bn or less in capital resources. The average number of employees in a non-state enterprise was just 31 at the end of 2002, ranging from 258 in equitized firms to 62 in joint stock companies, 39 in limited liability companies, and a mere 14 in private firms. The average assets, per single employee, in non-state firms was VND43m (less than a quarter of that for central SOEs), ranging from VND69m in equitized firms to VND59m in joint stock companies, VND41m in limited liability companies, and VND35m in private firms. The average net turnover per employee was VND214m, ranging from VND271m for private firms to VND59m for joint stock companies.

2. Methodological approach

As mentioned earlier, to our knowledge, no empirical survey of corporate governance practices across Vietnam's domestic business community has previously been conducted. In this respect, this survey was an exploratory piece of research. However, we were able to draw upon the experience of similar studies conducted in other transitional economies, and the design of the questionnaire used in the interviews benefited greatly from lessons learnt in previous studies. Given the subject matter, and our desire to gain a broad overview of actual practices in companies, we felt that interviews lent themselves best to extracting useful information and insights.

2.1 Interview questionnaire

A lengthy questionnaire spanning the main elements of corporate governance was designed to ensure that the interviews were as consistent as possible across the full sample. However, given the relative diversity of firms interviewed, not all of the questions were relevant for every company in the sample. For example, some questions on shareholder rights were irrelevant for SOEs that are wholly-owned by the state and therefore subject to a different set of corporate governance laws, regulations and practices than private firms. Similarly, other questions regarding the direct relationship between enterprises and state agencies applied only to SOEs.

2.2 Survey sample

We deliberately sought to include large companies, as measured by size of assets, turnover, and the number of employees, in the survey sample. We did not seek to include firms that have the legal status of household enterprise, regardless of their size. In composing the sample, we also deliberately sought companies that were working in different business sectors from each other, so as to capture a broad picture and to avoid any bias that might stem from corporate governance practices in specific business sectors. (We did not include banks or finance firms in the sample, and included just one trading company.) As most of the companies surveyed are large, relative to most firms in Vietnam, we might expect their corporate governance practices to be more advanced than most, if only because of the need to better manage these larger entities.

2.3 Quantitative and qualitative data

Much of the next chapter contains simple frequency results which depict the proportion of firms in the sample that responded one way or another to a series of closed questions. These are supplemented, and given added color and depth, by some more qualitative results that principally stem from comments made by interviewees. With a sample size of only 85 firms, one could argue that the frequency results are not statistically significant and cannot accurately represent - or be extrapolated to portray - the entire corporate sector in Vietnam.¹⁰ But as an exploratory piece of empirical research, we do believe that this survey provides an insightful, and initial, snapshot of corporate governance practices in Vietnam. As a result, the percentage frequencies cited are useful in getting a sense of broad trends and differences across the sample.

2.4 Interviewees and potential biases

In terms of the specific people interviewed at each of the 85 firms, 55% were general directors or managing directors of the company, 28% were chairs of the Board of Management, 15% were deputy directors, 11% were members of the Board of Management, and 5% were heads of the accounting or finance department. It should be noted that some interviewees held more than one senior position in the company, such as general director and chair of the Board of Management. Among the non-SOE sub-sample, 56% were general directors or managing directors, 15% were deputy directors, and 44% were chairs of the Board of Management. Within the SOE sub-sample, 55% of interviewees were general directors or managing directors, and 16% were deputy directors. It is recognized that there is likely to be some degree of bias in the views of specific individuals on their respective firms' corporate governance practices. However, despite seeking a more balanced and nuanced perspective, the survey team lacked the time and resources to interview multiple individuals in each firm.

Clearly, another area of potential bias stems from the kinds of questions we posed in the survey. Even though we assured interviewees that all responses would be aggregated, and no specific individuals or company names would be cited in this report, it is unlikely that interviewees would openly provide responses that, in effect, showed they were knowingly breaking laws and regulations pertaining to corporate governance. Apart from being cognizant of this potential bias, there was little we could do to control for it in the survey work.

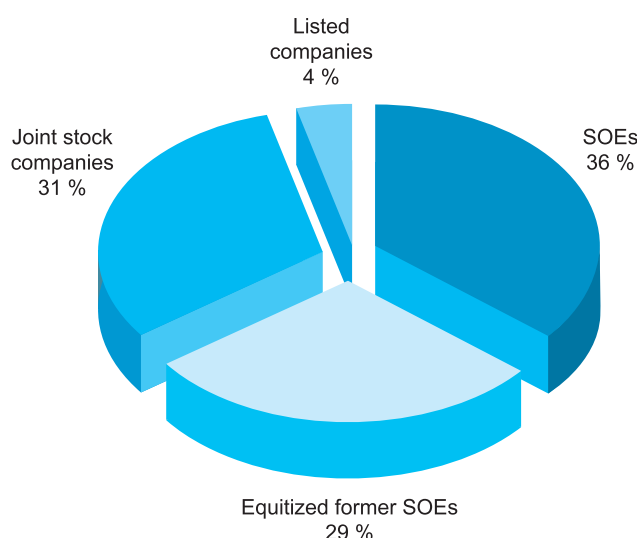
¹⁰ This is even more true for the sub-samples of SOEs (consisting of 31 enterprises) and non-SOEs (54 firms), with the latter comprising of: 25 equitized firms; 26 joint stock firms (unlisted); and three listed companies.

3. Profile of the 85 firms surveyed

3.1 Location and ownership status

Of the 85 firms surveyed, 59% were located in and around Hanoi, and 41% were located in and around Ho Chi Minh City. A broadly similar north-south division was apparent within both the SOE sub-sample, and the non-SOE sub-sample. Thirty-six percent of the companies interviewed were SOEs under total state ownership, while the remaining 64% of firms were non-SOEs. These non-SOEs spanned: i) 25 equitized former SOEs (including some where the state retains some ownership share) that are now joint stock entities; ii) 26 firms that had always been private joint stock companies; and iii) three companies currently listed on the fledgling Ho Chi Minh City stock market. Figure 1 below provides a detailed breakdown of the sample, by ownership status. Of the 31 enterprises in the SOE sub-sample, 25 were owned by central government and 6 were owned by provincial or municipal government. Within just the SOE sub-sample, 42% of enterprises were classified as Corporation 91 (or 91-corporation) and 13% were classified as Corporation 90 (or 90-corporation).¹¹

Figure 1: Breakdown of sample by ownership status



¹¹ In 1994, the Prime Minister issued Decisions 90/TTg and 91/TTg, creating general state-owned corporations that brought together previously separate SOEs in particular sectors - e.g. separate state-owned companies in the garment sector were brought under the umbrella of Vinatex (Vietnam Textile and Garment Corporation). Corporations established by these two Decisions are commonly referred to as "Corporation 90" or "Corporation 91."

3.2 Size (employees, equity, revenues, and profits)

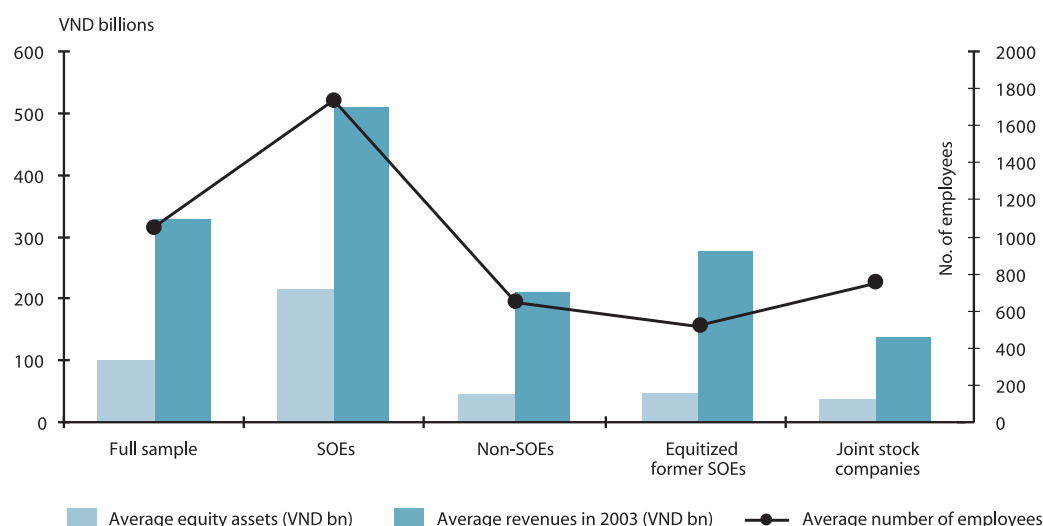
Across the whole sample, the average number of employees in each company surveyed was 1,055. When broken down by ownership status, the average number of employees was: i) 1,740 in the SOE sub-sample; ii) 647 in the non-SOE sub-sample; iii) 516 in the sub-sample of equitized firms; and iv) 752 in the sub-sample of joint stock firms.

The average size of equity assets (excluding loans) held by firms across the full sample was VND99.98bn (around US\$6.4m), ranging from: i) VND215.67bn in the SOE sub-sample, to ii) VND44.45bn in the non-SOE sub-sample as a whole; and iii) VND35.34bn in the joint stock company sub-sample.

The average revenues (in 2003) for the full sample was VND328.22bn (around US\$21m), ranging from i) VND510.43bn for the SOE sub-sample, to ii) VND210.79bn for the non-SOE sub-sample; and iii) VND136.29 for the sub-sample of joint stock firms. Just six of the 85 firms surveyed claimed to have made a loss in 2003, of which just one was an SOE, one was an equitized firm, and four were joint stock firms. The bulk of firms surveyed claimed to be profitable businesses.

Not surprisingly, most SOEs tended to be larger corporate entities than private firms, and even equitized former SOEs, whether measured by equity size, revenues or employee numbers (please see Figure 2 below). The reasons for this are principally: i) a legacy of the centrally-planned economic system, which resulted in the creation of large state-owned firms; ii) the relative youth of the private sector in Vietnam, which has yet to develop many large-scale firms; and iii) the bulk of equitizations to date, which have been partial divestments of smaller SOEs (very few large-scale SOEs have undergone partial privatization).

Figure 2: Average size of sample, by assets, revenues and number of employees



3.3 Business sectors and sources of finance

The kinds of business activity pursued by the 85 firms were diverse, with no single business sector accounting for more than 12% of the total sample. Firms in the construction or construction materials sector accounted for just under 12% of the surveyed companies, and mechanical engineering or metal processing firms accounting for just over 8%. Other business sectors represented in the sample included: garments and textiles; fuels, power and energy; food and food processing; and transport, among various others. Some of the larger companies in the survey sample were active in multiple business sectors. The two figures below shows the sampled firms' differing proportion of sales to overseas customers,¹² and their principal sources of financing.

Figure 3: Proportion of sales to overseas customers, by type of company

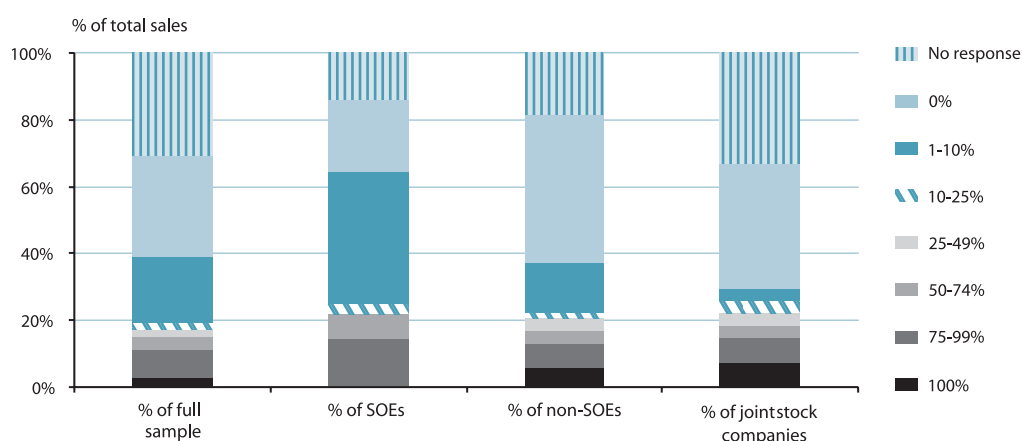
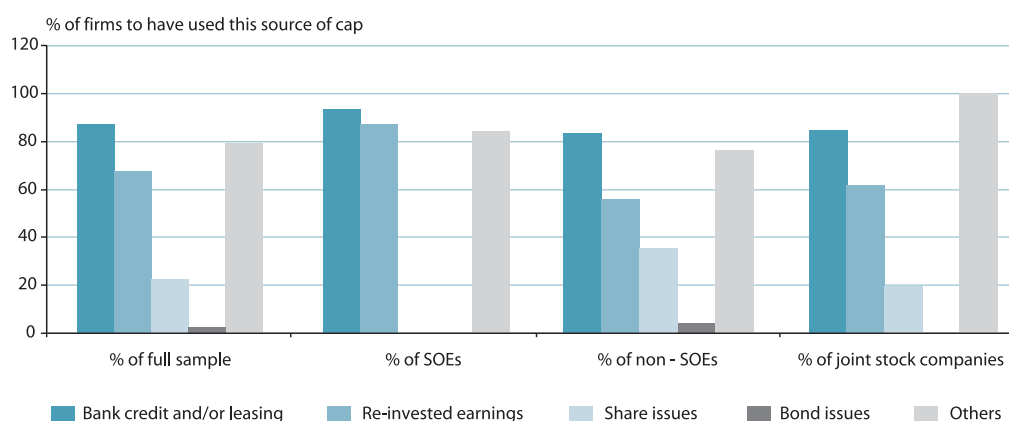


Figure 4: Sources of finance

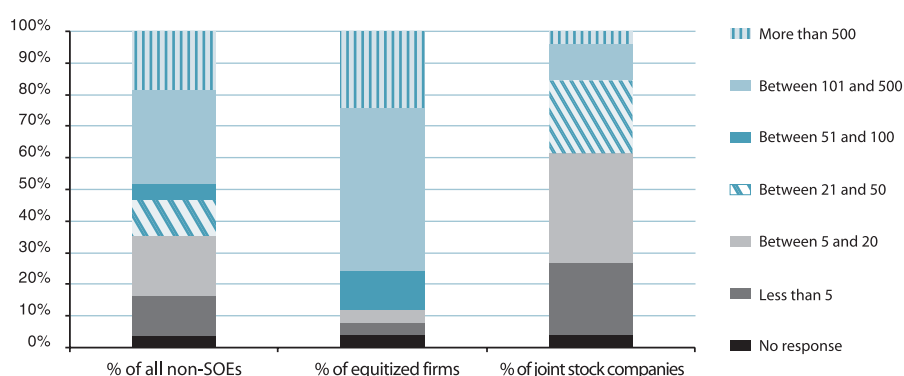


¹² This included both exports and sales to foreign firms with a permanent presence in Vietnam.

3.4 Diversity and number of shareholders

In the case of the 54 non-SOEs in the sample, there was a fairly wide number of shareholder profiles, as indicated in the figure below. Roughly 40% of firms surveyed had one or more subsidiary companies, and 60% had no subsidiaries. (This breakdown was also broadly consistent across the different ownership forms.)

Figure 5: Number of shareholders in surveyed firms



On average, equitized enterprises in our sample have more shareholders than joint stock firms. As shown in Figure 5, the majority of equitized enterprises have more than 100 shareholders, whereas most joint stock firms have no more than 20. This trend is not surprising, as equitization has placed a particular emphasis on share sales to employees at the time of partial divestment. As a result, many employees of equitized firms hold shares in their own company. Conversely, shares of joint stock firms, in many cases, are quite closely held by friends and family members. Six joint stock enterprises (i.e., roughly a quarter of all joint stock firms interviewed) have only three or four shareholders, and one joint stock firm had only one 'real' shareholder (see the case study below).

Profile: a joint stock company

Box 1: A one-man joint stock business

Company A is a joint stock company, operating in the highly competitive garment industry. It has nearly 1,000 employees, and equity capital of more than VND 20 billion. The director is also the sole owner of the firm. He established the firm in 2001 as a joint stock enterprise because he thought a joint stock firm, as compared to other legal forms of private firms, would have better opportunities to raise capital and expand. However, the 1999 Enterprise Law requires that a joint stock company must have at least two shareholders. He got around this by 'assigning' a small number of shares to two of his friends. Consequently, he does not perceive most of the legal requirements of a joint stock firm - such as an annual general meeting of shareholders, the establishment of an Inspection Committee, and even the charter - as relevant to his company.

Survey finding

3 CHAPTER

1. Corporate governance formally observed in most firms

1.1 Company charters and their equivalent

In terms of basic legal compliance, our survey findings suggest that most companies have the necessary corporate governance structures in place to conform to existing laws and regulations. Just under 92% of the firms surveyed had a company charter or equivalent document, with the exceptions being six SOEs and one joint stock company. It is perhaps worth noting that, despite the fairly large size of the firms in our survey, relatively few companies (15%) had had their company charters drafted by an outside law firm or business advisory firm. Rather, most had taken a 'do-it-yourself' approach, and drafted their own company charters, either by management and/or the Board of Management. Officially at least, few companies admitted to largely copying other companies' charters and then making minor or major revisions to suit their own specific needs.

While the majority of firms are able and willing to independently draft their charter and ensure that it does not breach existing laws and regulations, a number of SOEs within larger General Corporations claimed that the wording of their charter was, to a large extent, imposed by the General Corporation. One director said:

"The charter was in fact written by someone else, and yet we have to follow it. It would be much better if it had been written by us. As an SOE, I understand that we must operate under the SOE Law. However, our business activities are also restricted by the General Corporation. For example, the enterprise was not permitted to export directly, even when we found some foreign customers. Exports had to go through another enterprise that was allowed to export directly, and we had to pay 20% of the export revenue to that enterprise. And because we were not allowed to export directly, we were not allowed to open an account at Vietcombank."

Similarly, the general director of an engineering and construction SOE complained that "while in principle the enterprise can do anything that is not prohibited by the law, when we actually included some activities in our company charter, the General Corporation rejected them." Another SOE general director identified some points in his company charter that he thought were inappropriate or irrelevant, but did not want to change it, because this would be bureaucratic and troublesome.

When asked to provide us with a copy of the company charter, just under half of firms agreed, 38% declined, and the remaining 12% gave no clear response. Equitized firms appeared to be slightly more willing, as compared to joint stock firms and SOEs, to share a copy of their charters. This may be a function of the equitization process (i.e., the divestment by the State of some of its shares in the company), which either results in the drafting of a more robust company charter, and/or the adoption of a more open approach by the company's management.

We also sought to ascertain what specific corporate governance provisions were contained within these company charters. In the case of six provisions relevant only for non-SOEs, our findings showed that:

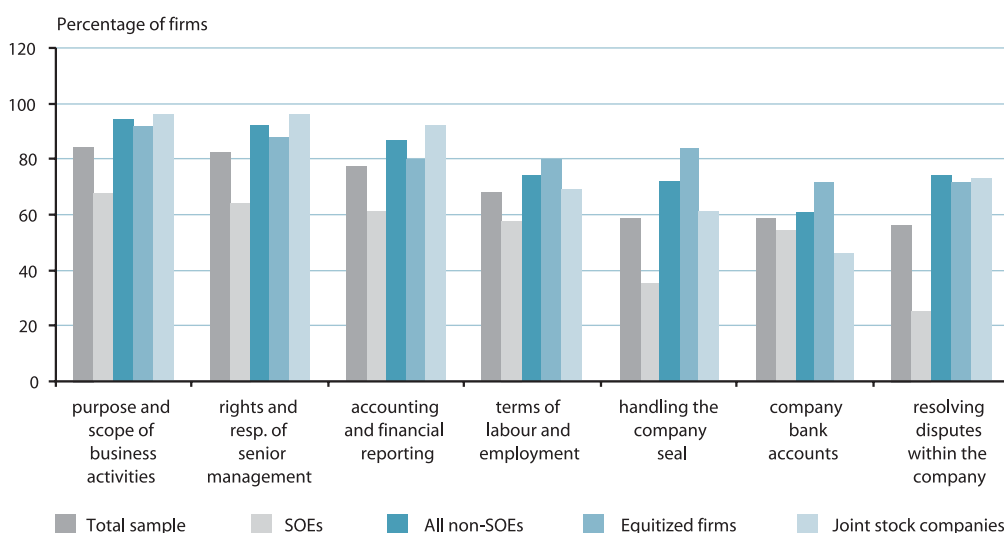
- 96% had charter articles related to the rights of shareholders;
- 96% had charter articles related to the rights and responsibilities of the Board of Management;
- 93% had charter articles related to the calling and holding of general shareholder meetings;
- 92% had charter articles related to the dividend payment process;
- 89% had charter related to the issuance of shares and the holding of share certificates; and
- 85% had charter articles in their charter related to the rights and responsibilities of the Inspection Committee.

Again, the broad impression one gets from the survey results is that of an apparently high degree of legal compliance, at least in terms of guidelines written in the company charter or its equivalent.

With regard to seven other specific corporate governance provisions that apply to both SOEs and non-SOEs alike, the figure below shows the proportion of firms that address these in their company charters. While the picture is fairly mixed, SOEs appear to have less coverage of these provisions in their charters or equivalent documents. However, based on this evidence alone, one may not be able to claim that SOEs are less formalized in this regard, as relevant government agencies prepare and apply many

aspects of SOE governance and management to all SOEs. For example, the issue of 'resolving disputes within the company' may not be specified in an SOE's company charter, but it is normally covered in the so-called 'collective labor agreements' and regulations that concern the relevant trade union(s).

Figure 6: Proportion of firms with seven specific provisions in their company charters



One important caveat to note is that while the surveyed firms acknowledged whether or not these specific provisions were included in their company charters, we could not get a sense of how clearly these provisions were actually stated. Put another way, the inclusion of such provisions in a company charter does not necessarily mean that they are articulated correctly and clearly, provide adequate guidance, or even conform to relevant existing regulations. When asked if, in general, companies found their charter to be a useful document, 78% replied in the affirmative, 11% did not think so, and 11% had no view.

While the majority of firms found the company charter to be useful, a small proportion thought otherwise. For example, the general director of one SOE commented:

"The charter of my company is outdated. We want to change it, but we need approval from the 'ownership ministry' first. The process is very complicated and troublesome, so we have decided not to try and change the charter. Because we are an SOE, the charter is not so important. When we established a joint stock enterprise, we had to hire a consultant who spent several months drafting hundreds of pages for the company charter, and after that we discussed the draft for several months before it was completed."

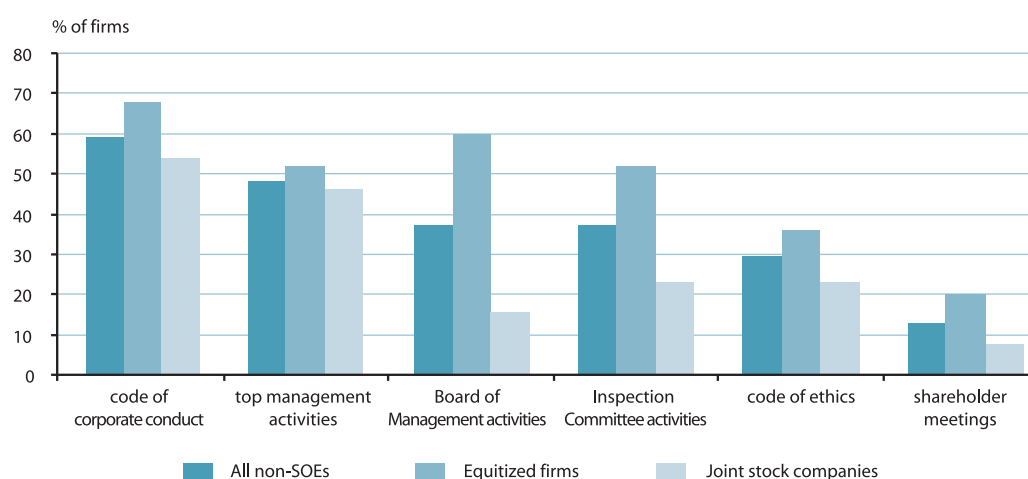
One joint stock firm also had a low opinion of the company charter's usefulness. The manager explained that the firm "is very united, and we are building the enterprise along the lines of the Oriental model, placing more emphasis on human relationships than laws." Another joint stock firm did not see the relevance of a charter, primarily because, as the general director explained, "the company's Board of Management and senior executives are the same people."

Across the full sample, just over 68% of firms claimed to follow their company charters closely or very closely in practice, with less than 4% stating that they did not do so. If these responses are to be taken at face value, it appears as if equitized firms adhere to the company charter in practice more than joint stock companies or SOEs, although the margin of difference is not particularly large. Over 62% of the full sample completely disagreed with the statement: "We have a company charter because it is required by law. But in reality we do not use it." Conversely, just 18% partly or completely agreed with this statement. (The responses were broadly similar across the different sub-samples.)

1.2 Other documents and guidelines

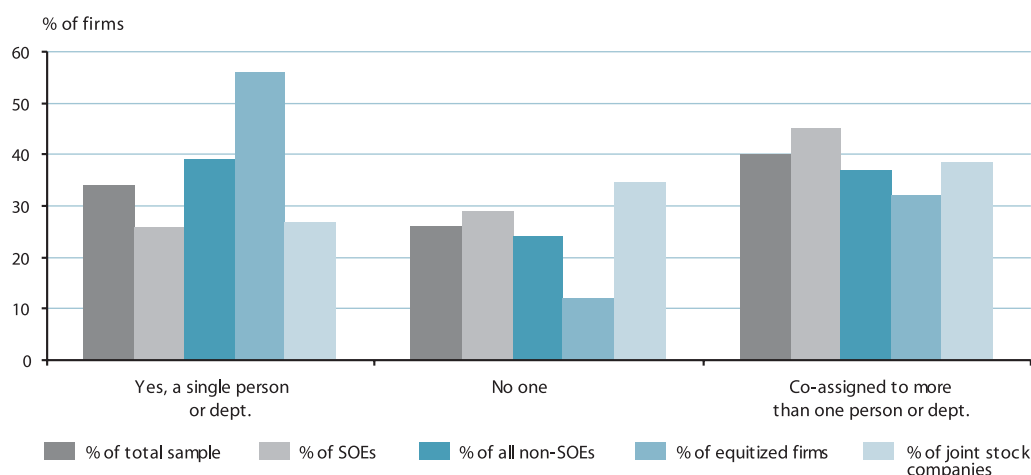
Almost three-quarters of the full sample of firms also claimed to have additional written documents - such as policy statements, guidelines, code of ethics, or 'noi quy' - that contained supplementary provisions on corporate governance-related issues beyond those in the company charter. Across the sub-samples, 88% of equitized firms claimed to have such documents, in contrast to just 58% of joint stock firms and 77% of SOEs. The figure below depicts the kinds of supplementary written documents that non-SOE companies surveyed tend to hold, and again suggests that equitized firms are better 'equipped' with such materials.

Figure 7: Additional guidelines or regulations on corporate governance provisions



In perhaps one of the most revealing parts of the survey, firms revealed whether or not any specific individual or department had been formally assigned to ensure the company's compliance with its own internal guidelines and/or current government regulations on corporate governance practices. The results are depicted in Figure 8 below. Notwithstanding the fact that 56% of equitized firms surveyed claimed that a specific person or department had indeed been assigned this compliance task (the highest proportion across the sub-samples), it is quite striking how many firms across the full sample do not seem to have formally allocated anyone to this important role. Nonetheless, the role of ensuring compliance was, in most cases, assigned to one of the functional departments within the company. The personnel and/or administration department - and the Inspection Committee, in the case of non-SOEs - were among the units most frequently cited. In some case, the secretary of the Board of Management was assigned to perform this role.

Figure 8: Proportion of firms to have formally assigned a person or department to monitor compliance



Finally in this section, 40% of the full sample of firms claimed to have written documents - such as a policy statement, set of guidelines, or an internal manual - pertaining to corporate social responsibility (CSR) issues, while 60% did not. Across the sub-samples, it is interesting to note that SOEs appear to have the highest proportion of CSR documentation, with 55% replying in the affirmative, in contrast to just 23% of joint stock firms and 40% of equitized firms. However, it is worth noting that although many firms interviewed did not formalize their CSR policies in writing, they are in one way or another engaged in ad-hoc social and charity activities, such as giving donations to the poor and disadvantaged or sponsoring social activities and events.

Across the full sample, 61% of surveyed firms held some form of ISO certification, and 39% did not. Roughly 70% of both SOEs and equitized firms had some form of ISO certification, in contrast with less than 35% of joint stock companies.

2. Limited concept of shareholder rights

The next section of the survey focused on the way companies treat their shareholders and protect their rights. This part of the survey was only conducted with the 54 non-SOEs.

2.1 Share registries

All of the firms surveyed had a share register, with 89% holding it internally by the company itself. Just 11%, comprised of the three listed firms, one unlisted joint stock firm, and two equitized firms, used an independent registrar or some other external recorder. Just over 57% of firms updated the share registry immediately upon any change in the shareholding, and 28% did so at intervals of between three months and one year. Almost 80% of firms surveyed had written procedures for conducting share transfers; 84% of equitized firms and 73% of joint stock companies. Just over 74% of firms had a single class of shares, while 22% claimed to have more than one class of share; 32% of equitized firms and 15% of joint stock companies. In the large majority of cases (85%), one share represents one vote. A broadly similar result was found for each share being entitled for an equal proportion of total dividends, with just a few exceptions.¹² Almost 56% of firms surveyed believed that there was some trading, either formal or informal, in their shares, ranging from 76% of equitized firms to 31% of joint stock firms that were interviewed.

2.2 Shareholder meetings

Slightly over 85% of non-SOEs surveyed claimed to hold annual general meetings (AGMs) each year, with just a small number (mostly unlisted joint stock firms) apparently not doing so. Most of the firms that do not hold AGMs are either newly established, or so closely held, that they do not see the need to hold a formal AGM. A director of such a closely held firm argues that the requirement for a joint stock enterprise to have an annual general shareholders meeting is not relevant to closely held firms, and should be changed.

¹² With just under 80% of surveyed firms having a written policy on declaring and paying dividends.

Figure 9 depicts the different ways that firms announce upcoming general meetings to shareholders, with many using multiple means. Figure 10 shows how much advance notice is given by companies, between the announcement of an AGM and it actually being held. It is quite striking how little advance notice is given, particularly in the case of joint stock companies.

Figure 9: Methods of announcing upcoming general meetings

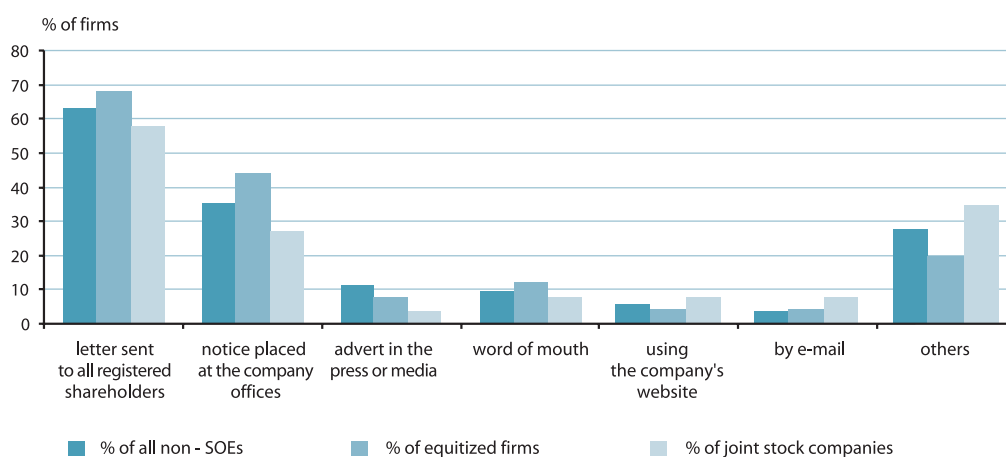
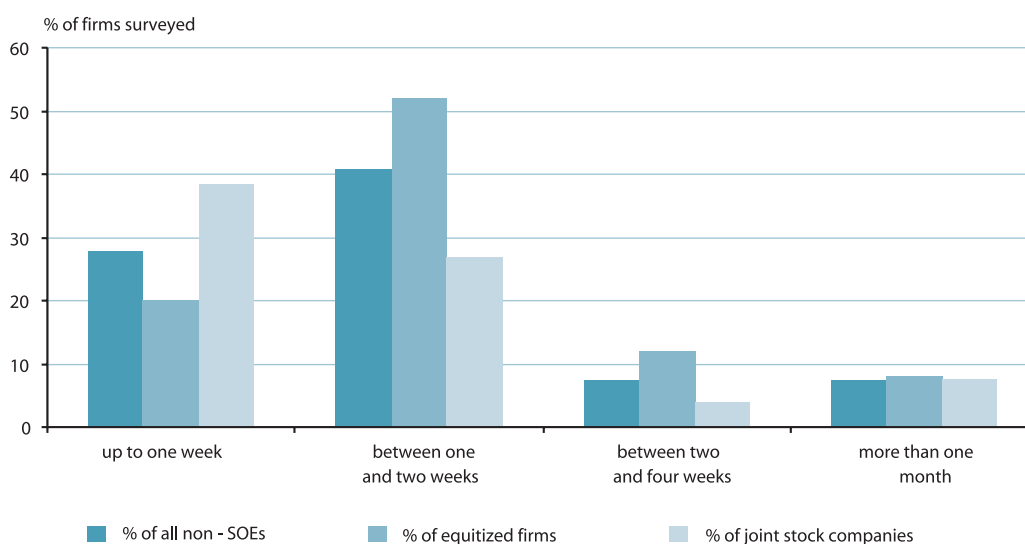


Figure 10: Advance notice of a general meeting of shareholders



2.3 Shareholder disputes

In terms of shareholder disputes, less than 10% of surveyed firms said they had experienced such an incident, with 87% emphatically saying they had not. Most of the disputes that occurred were, according to the interviewees, minor, in some cases stemming from misunderstandings among individual shareholders who traded shares with each other. There was, however, tension between state shareholders and other shareholders in some equitized enterprises, as the case study below illustrates.

2.4 Profile: an equitized SOE

Box 2: Still managed like an SOE

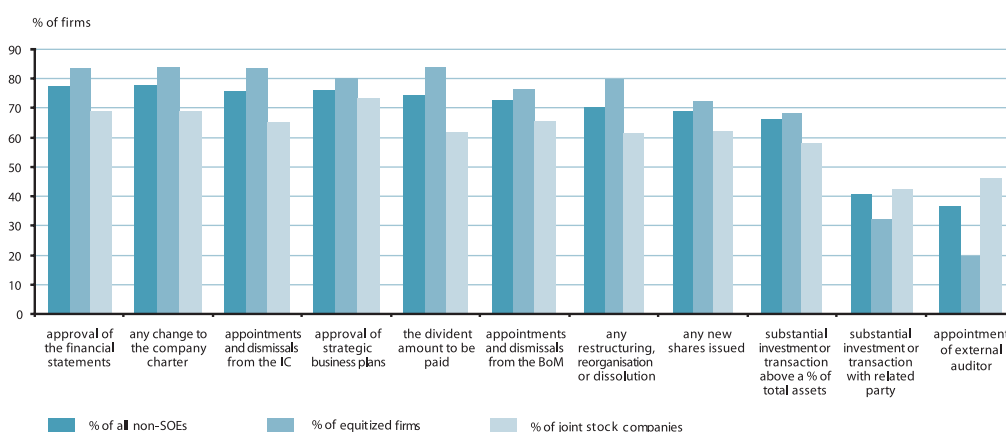
ABC is a construction company that was equitized in 1999. Before equitization, the company was a member of the state-run Hanoi Construction Corporation. The state (through the Hanoi Construction Corporation) still holds a controlling stake of 64% shares, and three people from the Corporation have been assigned to act as representatives for the state's equity. According to the company's head of personnel, these (state) majority shareholders sometimes impose their control on the company. They have conducted activities that contradict the Enterprise Law because "they work for SOEs, and so they prefer to apply the State Owned Enterprise Law instead." These three shareholders need to discuss and agree among themselves first; then they have to report to - and get approval from - the Corporation. The process can be very slow and business opportunities are sometimes lost as a result. "We have now decided that, for certain decisions, we should wait for only ten days; if we get no reply, then we just go ahead."

2.5 Shareholder voting

Congruent with the issue of shareholder disputes, 65% of the sample claimed they had never had an incident where shareholders voted against a Board of Management proposal at a general meeting. Just 22% of non-SOEs claimed that such an event had ever occurred. (The relevant respondents did not specify these incidents in detail, but they all claimed that the occurrences were relatively trivial and that the company faced few difficulties in resolving them.) Less than 19% of firms surveyed could recollect holding an extraordinary general meeting (EGM), and 76% claimed they had definitely not done so. Just two firms we surveyed had held an EGM that was initiated by shareholders, whereas eight others had EGMs called by their Boards of Management.

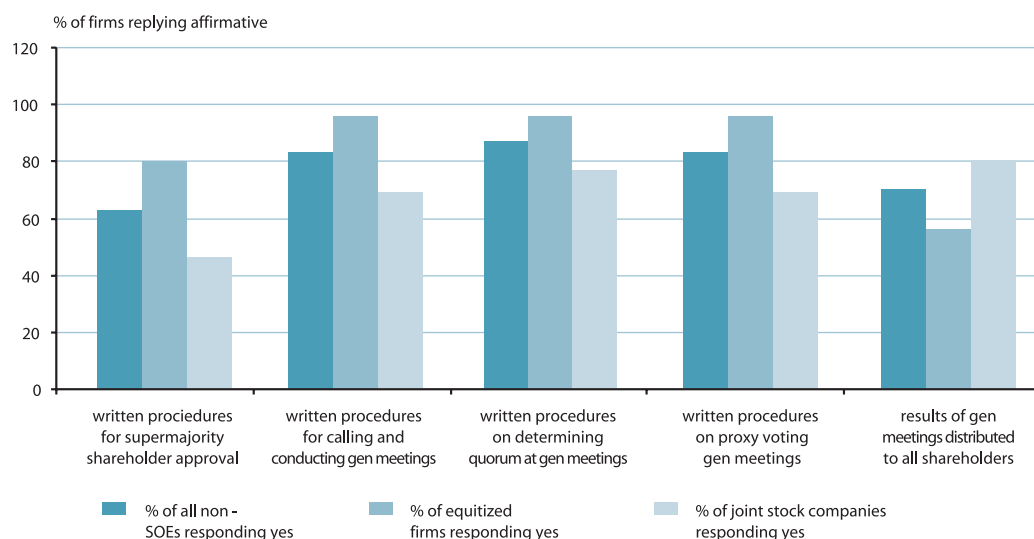
Nonetheless, it appears as if shareholders at most of the companies surveyed are generally able to vote at AGMs on most critical issues, as depicted in Figure 11 below. The broad trend seems to be that equitized firms are better in this regard than joint stock companies. However, specific issues where shareholder voting rights seem less than ideal, with less than half of surveyed firms conforming, relate to: i) appointments of the external auditor; ii) investments or transactions larger than a set proportion of the company's assets; and iii) large investments or transactions that entail a related party transaction.

Figure 11: Specific issues on which shareholders may vote at AGMs



Across the full sample of non-SOEs, 63% of firms do have written guidelines, either in the company charter or other documents, on the need for super-majority shareholder approval for certain key decisions or transactions. (Just over 24% of firms said they did not have any such guidelines, and the rest did not respond.) However, the proportion was much higher for the sub-sample of equitized firms (at 80%) than for joint stock firms (46%). A similar trend was seen for written guidelines on the procedures for: i) calling and conducting shareholder meetings; ii) determining a quorum at shareholder meetings; and iii) proxy voting. In contrast, however, a higher proportion of joint stock companies than equitized firms distributed the results and records of general shareholder meetings to all shareholders. This latter result may be a function of the wider shareholder base of equitized firms, relative to many joint stock firms that have a relatively small shareholder base (see Figure 12 below).

Figure 12: Written procedures on general shareholder meetings



2.6 Overall influence of shareholders

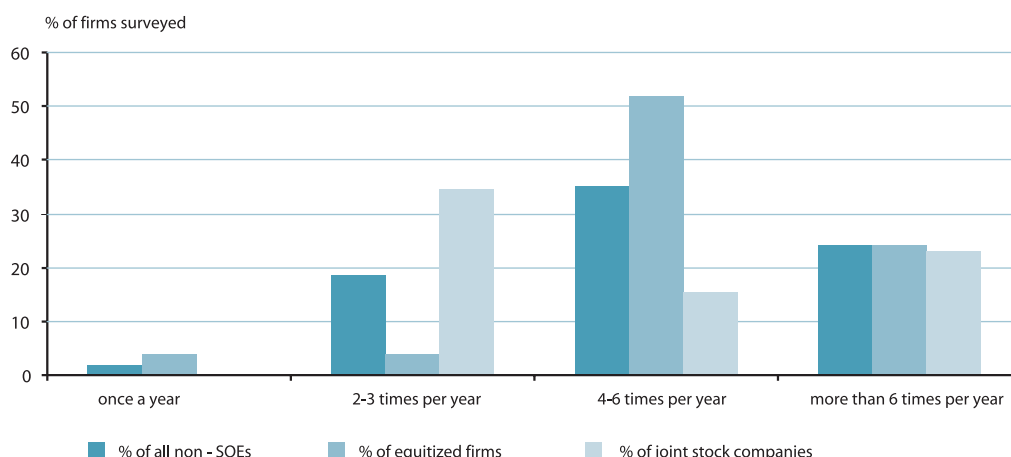
Finally in this section, we asked the surveyed firms whether they agreed or disagreed with the statement that: "in reality, shareholders have little influence over how the company conducts its activities, as this is basically decided by management." Just over 61% of respondents fully or partly agreed with this sentiment, with just 26% partly or completely disagreeing (and the rest not responding either way). Given that most of the individuals interviewed in this survey were senior managers, this result is particularly telling. However, due to time constraints in interviews, we were not able to explore this issue in greater detail. One possible explanation is that in many joint stock firms senior management are simultaneously owners or major shareholders. And in the case of equitized firms, many shareholders are employees, and they often do not have the ability, or confidence, to comment on management issues.

3. Unclear role and responsibilities of Boards of Management

3.1 Board of Management meetings

All of the non-SOEs in our sample had a Board of Management (with an average board size of six people), as required by law, and the large majority (all but two joint stock firms) claimed to have written documentation - such as a chapter in their company charter - on the precise functions and responsibilities of the Board and its members. Over 59% of firms surveyed had four or more Board meetings a year, and 24% had six or more (see Figure 13 below).

Figure 13: Frequency of Board of Management meetings



Virtually all of the equitized firms surveyed have formal agendas prepared and circulated before Board of Management meetings, and written minutes are prepared and approved after each meeting. However, only 62% of joint stock firms did the same, with 35% saying that their Board meetings are more informally structured, although more than 90% did prepare and approve minutes. Across the sub-sample on non-SOEs, roughly 65% of firms conceded that senior executives, who were not members of the Board, did nonetheless routinely attend Board of Management meetings. This was true for more than three-quarters of equitized companies and half of the joint stock firms surveyed. Just over 57% of non-SOE firms pay their Board members a fee, ranging from 76% of equitized firms to 35% of joint stock firms. Conversely, 20% of equitized firms and 58% of joint stock companies definitely do not pay fees to Board members.

3.2 Perceived effectiveness

As the figure below shows, general perceptions of the effectiveness of the Board of Management are positive, with 78% of non-SOEs responding that Boards are effective in monitoring the actions and performance of senior management, and 87% believing that the Board acts in the interest of all shareholders. One explanation for this is that in many cases, the Board of Management and senior executives are the same people. Twenty out of thirty managing directors interviewed were also chairman of the board of their respective enterprises. In more than a few cases, the respondents said that this question was not relevant as "they [the Board of Management and management] are the same."

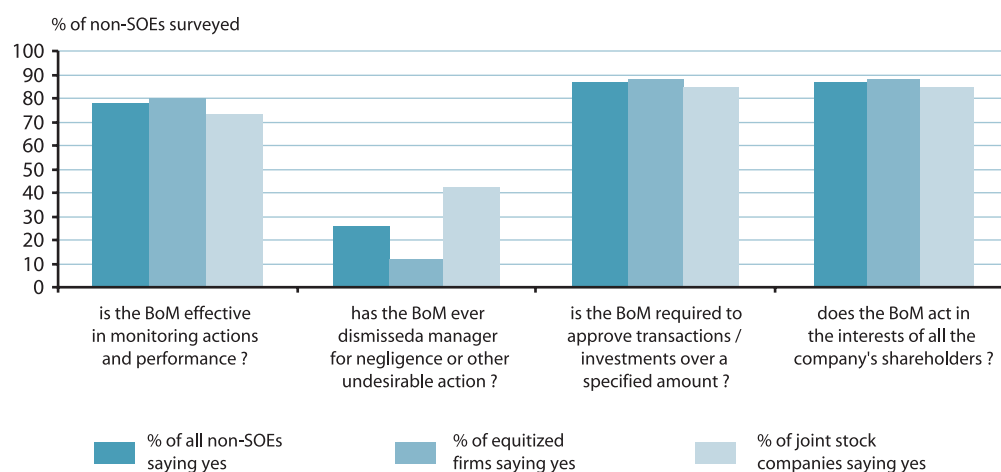
Although the majority of interviewees regarded their Board of Management to be effective, a small number had a different opinion. Interestingly, perhaps, five out of the seven respondents who said their Boards of Management were not effective were not

Board members themselves. A manager from an equitized enterprise commented: "In [many] equitized enterprises, members of the Board are holding management positions in other organizations or enterprises, and so it is difficult for them to understand and effectively monitor this enterprise." Another director of an equitized enterprise that had nearly all of its equity from other state enterprises and organizations, said "our enterprise is a joint stock firm, and we should be allowed to have private investors, so as to bring 'the market' into the firm. But board members do not care much about the firm, and we need to get their approval for most things."

3.3 Competence of members

A manager of a joint stock company argued that the "Board of Directors doesn't have sufficient time. In addition, its members are insufficiently rewarded and face unclear roles and responsibilities. These are reasons for the Board's ineffectiveness." Almost 78% of firms surveyed thought that their board members are competent or very competent in effectively carrying out their roles, with just three joint stock firms saying that some of their board members were not very competent. It is worth noting that a clear majority of firms (more than 75%) has at least one board member with a background or advanced qualification in financial management. More tellingly, perhaps, 59% of non-SOEs said that it was either difficult or very difficult to find people with the right capacity to be effective board members, against just 17% of firms who thought it was easy or very easy to find such people. Joint stock companies in particular seemed to feel this was a challenge, more than equitized firms.

Figure 14: Effectiveness of the Board of Management



3.4 Overall influence of the Board of Management

Finally in this section, the representatives of surveyed firms were asked if they agreed or disagreed with the statement that: "in reality, the Board of Management has little influence over how the company conducts its activities, as this is basically decided by management." Opinions were quite mixed, with just over 46% partly or completely disagreeing, and 43% partly or completely agreeing. Equitized companies tended to be slightly more negative on this issue than their joint stock counterparts.

4. Insufficient role and responsibilities of Inspection Committees

4.1 Presence of Inspection Committees

Although all of the equitized companies we surveyed had an Inspection Committee, 23% of joint stock firms in our sample seemingly did not. This is primarily because some joint stock firms are small, and therefore not required by law to have an Inspection Committee. Under the current Enterprise Law, only joint stock firms with eleven or more shareholders must establish an Inspection Committee. In the majority of cases, the Inspection Committee was appointed by shareholders at the annual general meeting, although in 17% of firms (mostly joint stock companies), this decision was made by the Board of Management. This is understandable, as in most joint stock companies, the Board of Management members are also the owners or majority shareholders. In all but three non-SOEs (one equitized company and two joint stock firms surveyed), the company's chief accountant / head of finance was not represented on the Inspection Committee. The frequency of Inspection Committee meetings seemed to vary greatly, although it appears that most of the companies surveyed have at least 2-3 meetings per year. The vast majority of equitized firms claimed to have written documentation on the precise functions and responsibilities of the Inspection Committee and its members, although only two-thirds of joint stock firms confirmed actual possession of such guidelines.

4.2 Expected functions and compliance

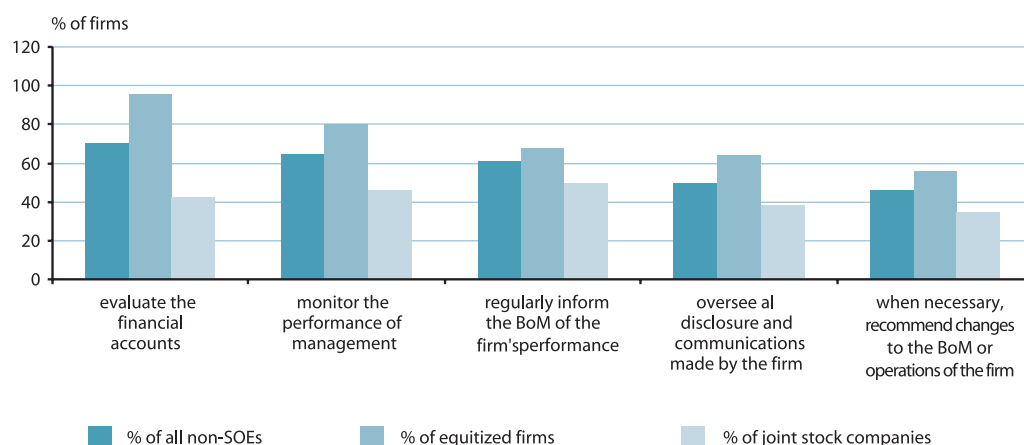
Under the Enterprise Law, Inspection Committees are expected to perform a number of important functions, principally related to their oversight role. However, as Figure 15 clearly shows, a substantial proportion of firms do not appear to be adhering to the law in this respect, and joint stock companies seem to be particularly remiss. Although not officially required under the Enterprise Law, there are a number of other functions that one could argue should be included within the Inspection Committee's responsibilities as part of a

company's pursuit of good corporate governance. Figure 16 identifies these additional functions, and again, the proportion of firms that claim to comply is relatively low.

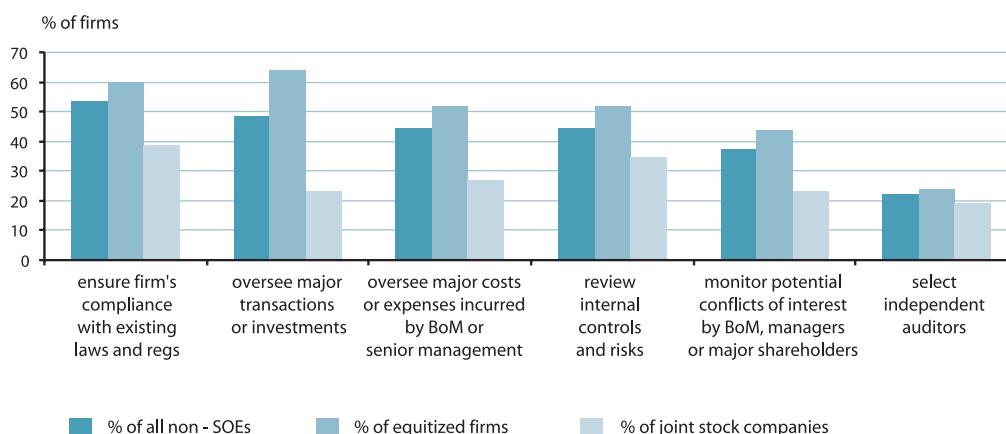
In a number of cases, the interviewees explained that low compliance occurs because the Inspection Committee members are not sufficiently competent to perform their job. However, some other interviewees did not agree. They believe that the Board of Management does not allow the Inspection Committee to perform its job properly. A deputy director of an equitized former SOE commented: "if the Inspection Committee does too much, the Board will remove them." Some thought because the Inspection Committee members are also employees of the firm, they lacked sufficient confidence to perform their job fully. Two interviewees expressed some degree of negative sentiment towards the Inspection Committee, saying "we are afraid of them," and "since equitization, they are the owners or representatives of the owners, so they overwhelmingly exercise their ownership rights." Ironically, these two interviewees rated their own respective Inspection Committees as being "very effective."

Just a third of non-SOEs surveyed could think of an incident when the Inspection Committee had found fault with some aspect of the company's operations, and 37% of respondents completely or partly agreed with the statement: "In reality, the Inspection Committee has little authority [and] only exists on paper because it is required by law." Forty-three percent of firms completely or partly disagreed, and the rest expressed no view.

Figure 15: Complying with the Enterprise Law on the functions of the Inspection Committee



**Figure 16: Additional Inspection Committee functions,
not required under the Enterprise Law**



4.3 Overall influence of the Inspection Committee

Based on these survey results, it does appear as if the Inspection Committee is a particularly 'weak link' in Vietnam's corporate governance 'chain.' This probably stems from both a combination of factors, including: i) inadequate regulatory guidance on what duties the Inspection Committees should perform; ii) insufficient implementation of these functions; and iii) a sense that Inspection Committees often lack sufficient authority to challenge senior managers and/or the Board of Management on specific issues. In cases where Inspection Committee members include company individuals who are technically subordinate to senior management figures, or even related to them, it is difficult for them to carry out their duties in a free and independent manner.

5. Weak internal controls over senior management

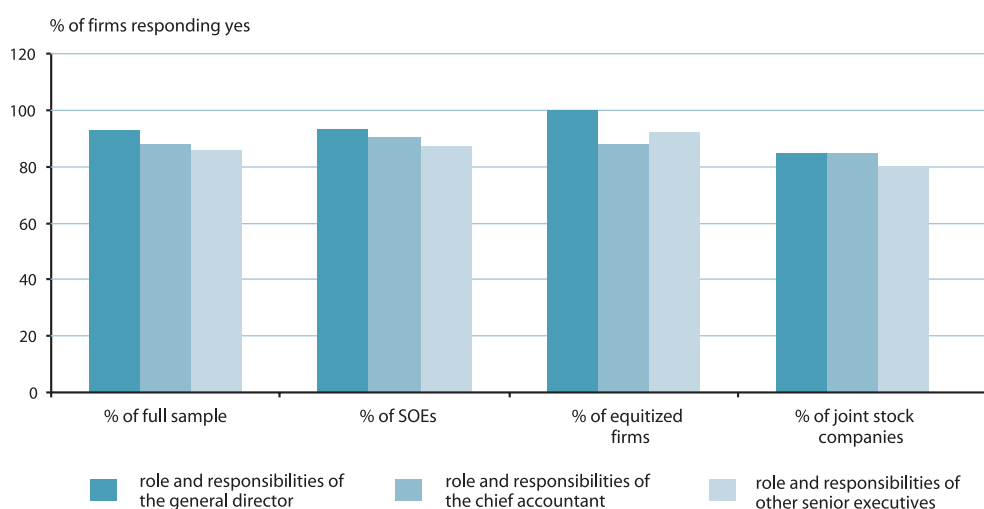
5.1 Documentation of senior management roles and duties

Across the full sample of 85 firms, the large majority of companies had written documentation on the precise role and responsibilities of the General Director, the chief accountant or the head of finance, and other senior executives. As the figure below shows, equitized firms appear to be slightly better in this regard, and joint stock firms seem to be the relative laggard.

In a bid to get some sense of whether personal relations, or nepotism, could potentially have an adverse effect on management decisions, we polled companies on the relationship between its general director and three other management roles. We found

that there were relatively few cases where: i) the firm's chief accountant was related to the general director (in just one equitized firm); ii) the head of sales was related to the general director (in one SOE, one equitized firm and one joint stock company); or iii) the person in charge of procurement was related to the general director (in two equitized firms and three joint stock firms).

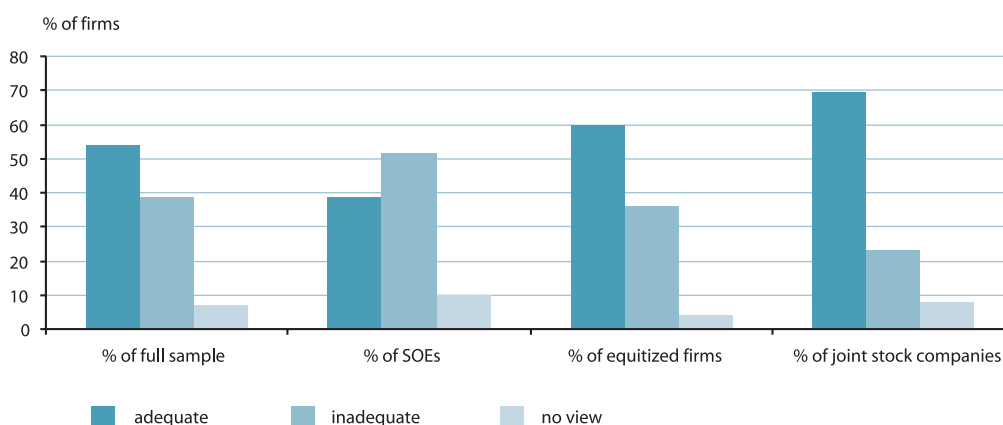
Figure 17: Proportion of firms with written guidelines on the role and responsibilities of senior managers



5.2 Remuneration of senior management

The temptation to abuse a position of authority for personal gain is obviously greater if the formal remuneration provided for that post is deemed insufficient. Across our sample, only 54% of firm representatives believed that the official salaries currently provided to senior management personnel were adequate. Discontent was most apparent in SOEs, and least apparent in joint stock firms, as the figure below shows. This can be largely explained by the fact that salaries in SOEs are, to a great extent, regulated by the government, and tend to be relatively low, whereas joint stock enterprises are free to pay market rates. In principle, equitized firms are also free to pay management whatever they see fit. However, many equitized firms still observe the old SOE way of doing things, and a number of equitized firms interviewed adopt a payment policy that is not so different from SOEs. In one interesting case, an equitized enterprise operating in the machine assembling and construction business decided to pay the general director a low salary, in line with the payment regulations for SOEs (i.e., only three times higher than the average salary of all company employees as a whole). The reason, according to the manager interviewed, was that the equitized firm must do this so that it can be regarded as a 'Category 1' enterprise, and therefore be eligible to bid for certain contracts open only to such firms. Relatively few firms surveyed had any kind of formal or informal share option scheme for their managers, and those that did tended to be almost entirely joint stock firms.

Figure 18: Views on official remuneration for senior management



5.3 Internal audits

With regard to internal auditing, we found that a surprising proportion (41%) of firms in our survey, given their relatively large scale, never conducted internal audits. Roughly half of the sample had formal procedures in place to maintain an adequate degree of control over the operations of subsidiaries, divisions or affiliates located away from company headquarters. Such a lack of internal risk controls can render companies vulnerable to abuse by senior executives, particularly in cases where the formal remuneration scheme is perceived to be inadequate. Respondents were asked if they agreed or disagreed with the statement: "in reality, the management does what it chooses, without much need to gain prior approval of the Board of Management or shareholders," to which almost 52% completely or partly agreed, and 36% partly or completely disagreed. The degree of agreement was highest in SOEs (which admittedly do not usually have Boards of Management, and just one owner), with almost 68% partly or completely agreeing, as the figure below shows.

Figure 19: In reality, management largely does what it chooses, without BoM or shareholder approval



5.4 Related party transactions

As with Inspection Committees, another area of particular corporate governance weakness in some Vietnamese firms is the issue of related party transactions and conflicts of interest. Less than 25% of the firms we surveyed claimed to have any written rules or guidelines to control related party transactions, with equitized firms the most well-protected against such abuse by quite a wide margin, and SOEs the least well-protected. Most of our surveyed firms also tended not to have any written guidelines on reviewing investments or other transactions that might result in conflicts of interest. As a consequence, less than 12% of firms could think of an investment or transaction that had been halted because it did not conform to the company's internal rules or guidelines.

A strong impression gleaned from the interviews was that the concept of related party transactions was not well understood nor codified in the Vietnamese context. In many cases, our interviewers had to spend time to explain it to interviewees. Within enterprises that lacked their own written rules or guidelines to control related party transactions, the interviewees referred to existing laws and regulations (e.g., procurement regulations) on the issue as an adequate check: "we don't need to have our own rules as everything is in the law and regulations." In some ways, perhaps, this is a valid argument. However, the general impression is that firms tend to react to regulations, rather than proactively adopting an internal mechanism to prevent related party transactions that can so easily siphon off value from the company, and therefore hurt shareholders.

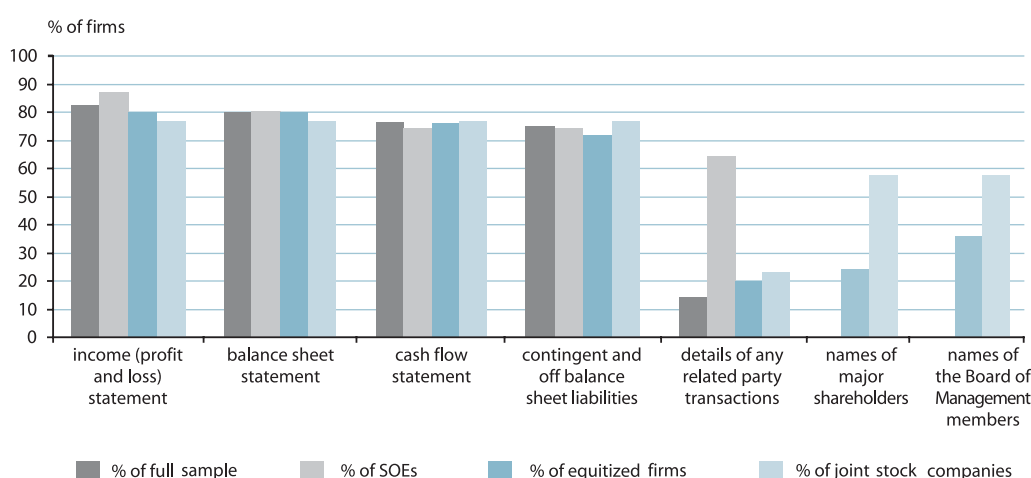
6. Low standards for company disclosure and transparency

6.1 External audits and annual reporting

Just over a third (37%) of all the firms in our survey did not conduct an external audit, with 46% of joint stock firms choosing not to do so. For those firms which did conduct an external audit, surprisingly few (13% of the whole sample) had any written rules or guidelines on ensuring that the auditors are genuinely independent of the company and/or members of the senior management. Nonetheless, 86% of firms we surveyed claimed to publish an annual report, with less than 10% (including 13% of SOEs) clearly stating that they did not. Figure 20 below depicts the main elements contained within these annual reports. However, just over half (51%) of firms surveyed conceded that the financial statements in their annual reports were not audited and approved by an

external auditor, while 38% that claimed they were. Sixty percent of the sampled firms claimed that their annual reports consolidated the financial performance of all subsidiaries or affiliates, and 69% claimed to also produce additional interim (semi-annual or quarterly) reports.

Figure 20: Annual report contents



Although two-thirds (62%) of all the firms surveyed had a company website, just a small proportion (8% of the sample) post their annual reports on it. The clear majority (81%) of firms surveyed felt that the annual reports they publish either largely or entirely reflect their company's true performance and financial position. However, rather tellingly, almost a similar proportion (78%) either partly or completely agreed with the statement: "it will be virtually impossible to make any major progress of financial disclosure by companies until Vietnam's tax system and its administration is improved." Only 8% of firms largely or completely disagreed with this view.

6.2 The role of banks and other financial institutions

Finally in this section, firms were asked to what extent they thought banks and other financial institutions in Vietnam, as the providers of credit and other funds, serve as monitors of the financial health and business operations of firms. Interestingly, 71% of firms did feel that banks do monitor their financial health to some or full extent, and 55% felt banks performed a similar role in monitoring their business operations. If so, banks and financial institutions are potentially the principal institutional guardians of corporate governance practices in Vietnam, for want of anyone else to assume this role.

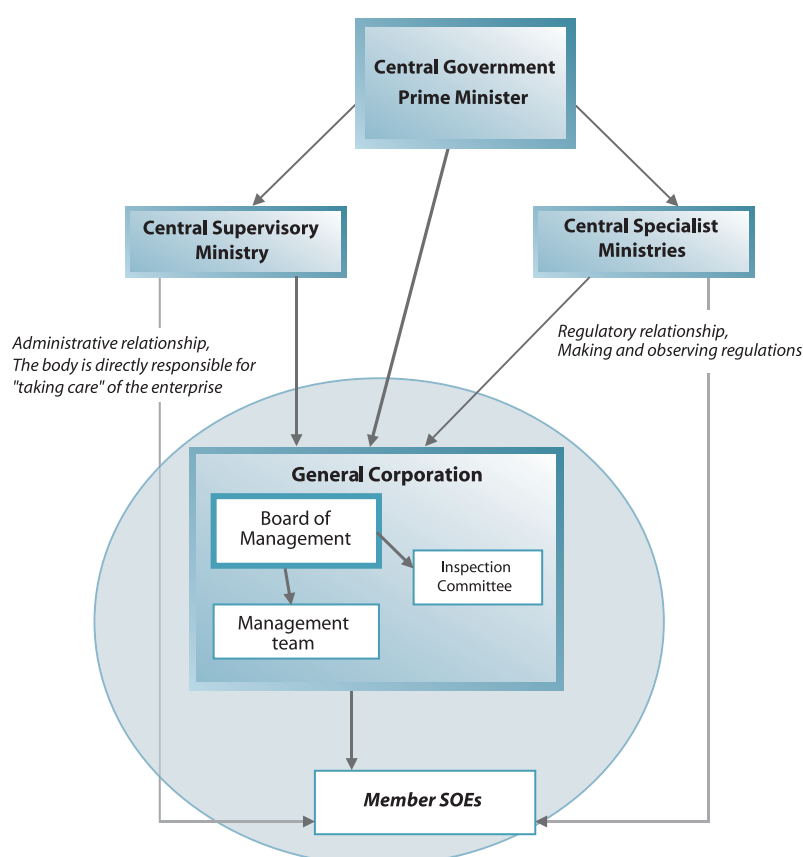
7. The special case of state owned enterprise

The issue of corporate governance in Vietnam's SOEs is a complicated topic that deserves a separate study of its own. In this section we do not seek to provide a fully comprehensive picture of the corporate governance practices of SOEs in Vietnam. Rather, we have sought to summarize some of the most important issues related to corporate governance practices within SOEs that came out of the survey. In particular, we focus on the direct relationship that exists between SOEs and state agencies, which is an issue for state firms only.

7.1 Complex governance structure

As mentioned earlier, the SOE sub-sample consists of 31 large enterprises, of which 25 are owned by central government and six are owned by provincial or municipal government. More than half of the SOEs surveyed are members of either '91-corporations' or '90-corporations'. The remainder are 'independent' SOEs, reporting directly to a national line ministry, a provincial or municipal People's Committee, or some other government organization. Figure 21 below provides a graphical description of the governance structure of 91-corporations.

Figure 21. The governance structure of 91-corporations



The governance structure of 90-corporations is very similar to that of 91-corporations. The principal differences are that 90-corporations are smaller and deemed to be less strategically important than 91-corporations. They were established by, report to, and are supervised by lower hierarchical levels (e.g., the chairperson of a provincial People's Committee, instead of the Prime Minister's office. The governance structures of 'independent' SOEs are different from 91-corporations and 90-corporations in that they do not belong to a larger general corporation. They report directly to their supervisory line ministry or provincial/municipal People's Committee. However, the governance structures of 'independent' SOEs are similar to general corporations in that they are directly supervised by, and report to, government agencies. Our survey confirmed some of the most common problems identified in existing literature as related to corporate governance practices within SOEs.

Much of the recent SOE reform effort has focused on mitigating the apparent confusion between the State's regulatory and ownership functions and on making SOEs accountable for their own profits and losses. The amended State Enterprise Law of 2003 is among the most recent attempts to address these kinds of issues. The Law intended to provide further autonomy to SOEs by empowering the Board of Management of General Corporations and by limiting the role of government agencies to regulatory functions. The Law has given and formalized the Board's role as the direct representative of the state's ownership of the corporation. However, the precise meaning of the term 'direct representative' is not clear; nor is the precise role of the Board.

According to the amended SOE Law, the Board has the right, on behalf of the corporation, to make every decision pertaining to the business of the corporation. However, the Law also states that the Board can only make those decisions, or do other things, that do not come under the rights and responsibilities of other state representatives and which are not assigned to other government agencies and organizations. The ownership rights of SOEs are currently exercised by various government agencies. For example, the Ministry of Finance acts as the representative for the state's capital, and is responsible for the administration of that capital. The 'supervisory ministry' (which is normally the ministry overseeing the relevant sector, such as the Ministry of Commerce or Ministry of Construction, in which the corporation operates) is responsible for the establishment, dissolution, personnel, and overall supervision of the enterprise. In addition, the Ministry of Planning and Investment is in charge of screening and approving large investments.

As a result, in practice, the role of the Board in many SOEs is not clear, and to a great extent, also quite limited. For SOEs that belong to General Corporations, they not only

report directly to the 'mother' entity, the General Corporation; but also at the same time have to deal directly with various government agencies on a number of important aspects of their business. All of the above often amounts to a de facto absence of ultimate ownership, as no one person or agency is directly, ultimately and clearly responsible for an SOE's performance. This state of affairs was generally confirmed by the various SOE directors who were interviewed during the survey. When asked "to what extent do you agree with the statement that SOEs have no real owners," 62% of respondents completely or partly agreed with the statement and only 24% disagreed.

7.2 Between market and hierarchy and the agency problems

For the sake of clarity, we refer to the relationship between SOEs and the government as being a 'principal-agent relationship', in which the former is the agent and the latter is the principal. As the principal of SOEs, the government, through its various agencies (e.g., the Ministry of Planning and Investment, Ministry of Finance, Ministry of Labor, Invalids and Social Affairs, and the Board of Management of the General Corporation), has established incentive schemes and monitoring mechanisms intended to ensure that the agent (i.e., SOEs) acts in accordance with the government's interests and to prevent the senior executives of SOEs from pursuing their own self-interests. As the economic reform and business liberalization process in Vietnam gradually unfolds, the governing strategy has changed from direct involvement in the decision making process of the enterprise to a more performance-based - or 'governing from a distance' - approach.

7.3 Capacity and competence of the "principal"

Profits, revenues and the amount of money contributed to the state budget have become among the most important performance criteria for SOEs. The enterprise (i.e., its management and employees) are evaluated and rewarded according to how well the enterprise meets these criteria. However, for such a system to work well requires the principal to know the business fairly well, set realistic objectives, and objectively monitor and evaluate the performance of the enterprise, all while taking into account the real capacity and market conditions in which the enterprise is operating.

Unfortunately, this is not always the case when it comes to SOE governance in Vietnam. In reality, the principals are government officials, and they often lack business knowledge. Government agencies commonly do not have the capacity nor expertise to closely monitor the performance of an SOE and then reward accordingly. In our survey, a number of SOE managing directors complained that the General Corporation (their immediate principal) did not understand their business. Most of the respondents did not think that the current corporation model is particularly effective, and according to some,

it only serves to add another administrative layer or barrier that constrains the pursuit of business. When asked to evaluate the capacity of the Board of the General Corporation to which their enterprise belongs, only 42% of those surveyed thought their Board has either complete or adequate capacity to run the corporation as a business organization.

Difficulties in assessment

However, it is not only the issue of the principal's capacity and competency that results from weaknesses in the 'governing from a distance' approach. For the approach to work effectively, the principal must also depend on the extent to which the agent can be determined and measured. In the case of the SOE sector in Vietnam, it is difficult to adequately assess the agents' status or performance, in terms of, for example, their real market value and actual productive capacity. This can be attributed in part to the under-development of market institutions, such as the banking system and stock market, in Vietnam.

Setting objectives

This lack of capacity in government agencies, coupled with the under-development of market institutions, has made the problems of asymmetric information in the SOE sector quite pronounced. In such a situation, the government agencies have seemingly opted for a 'laid back' administrative approach of setting 'growth' objectives for SOEs. For example, revenues or profits this year must be higher than that of last year, or the enterprise must grow by a fixed percentage every year, regardless of market conditions. There are also penalties for the general director if the SOE does not meet the objectives set out by the General Corporation and government agencies. For example, according to the State Enterprise Law, a general director can be dismissed if his/her SOE incurs losses for two consecutive years. It is true that there are also incentives for the general director if the SOE meets or exceeds the set targets. However, these incentives tend to be quite small, and considered by many to be insignificant.

This straight line 'growth' method of setting objectives is not particularly welcomed by many SOEs. When asked about the goals imposed by the government, twelve general directors answered that these were either extremely heavily imposed or heavily imposed by the government. One director described:

"The General Corporation assigns a yearly plan to the enterprise, using this mechanism. The government sets targets for the general corporation; say, a 10% rise in revenues and amount paid to the state budget. The general corporation then tentatively allocates these targets to its member enterprises.

Member enterprises then prepare their own plans, based on these guidelines, and submit them to the general corporation for approval by its Board. In general, the targets are heavily imposed, regardless of the market conditions. The underlying principle is that revenues or profits this year must be higher than last year."

"Ask and give"

As a consequence of the complex and unclear governance structure, SOEs are still largely dependent on government agencies, and the practice of 'ask and give' is still common. Examples of 'ask and give' are many. One respondent said that 'ask and give' is unavoidable; "given the current institutional arrangements, in many situations you found yourself being put into a jar, and so if you want to get out you have to 'ask.'" Investment activity appears to be the area that involves most 'ask and give' activity. In order to make a large investment, an SOE has to get approval from a number of agencies and the process is not always straightforward.

Personal relationships

Personal relationships between SOE managers and government agency officials are deemed to be important. When asked to rank the importance of personal relationships between management and government agencies that the SOE has to deal with, 87% of respondents rated the relationship as either important or very important. There was some anecdotal evidence that SOEs that have good relationships with relevant agencies were treated favorably. The director of a printing enterprise said:

"although operating in the same industry, some firms receive funding from the state budget, while others can only borrow from commercial banks. While most of firms must pay revenue tax, some firms do not, claiming that they serve social purposes. And yet they do business like others. It depends to a large extent on the relationship between enterprises and relevant government agencies."

One way to build a good relationship with officials in government agencies is to employ their relatives or persons introduced by them. When asked whether their enterprise has employed people introduced by state agency officials, the majority of SOE respondents (87%) answered in the affirmative.

Agency problems

The real impact of this approach adopted by the principal (i.e., the government) on the performance and practices of the agent (i.e., SOEs) remains to be seen. It is, however,

evident from this survey that the approach does not effectively resolve agency problems. The requirement for profit and/or revenue growth every year does not encourage SOEs to make or report a large profit. If a firm makes a large profit this year, it will be asked to generate an even higher income next year, regardless of any deterioration in market conditions. It is therefore widely believed that many SOEs opt for a stable growth strategy. When asked "to what extent do you agree with the statement that the common approach of SOEs is "to make no loss, but only a little profit," 70% of respondents surveyed either agreed or strongly agreed with this statement, and only 22% disagreed. Under the current 'carrot and stick' system, the director of an SOE "is rewarded little if the enterprise earns a lot of profit, but can face severe punishment if the enterprise makes a loss," argued one general director. Such a scenario, whether real or perceived, certainly would not motivate an SOE general director to invest for the long term development of an enterprise. Rather, a safe strategy would seem to be the order of the day. When asked "to what extent do you agree with the statement that the current reward system motivates you to try your best to maximize the company's profit," 57% of SOE managers surveyed disagreed, and only 23% agreed.

The regulation that an SOE general director will be dismissed if the enterprise incurs losses in two consecutive years may also prompt attempts to manipulate the financial accounts, so that he or she can retain their position. We did not find any evidence from the survey to support this possibility. However, numerous directors believe that the practice is common. One director said "there are certainly firms that try to smooth their earnings, spreading out their profits and revenues, so that they can meet the criteria set by government agencies." When asked "to what extent do you agree with the statement that many SOEs are profitable on paper only, but in reality, they are making losses," 82% either strongly agreed or partly agreed with the statement.

Possibly the most serious agency problem is that of 'kick-backs' (i.e., illicit commissions paid to individuals for services or goods provided). The majority of recent reported corporate governance malpractices in the SOE sector have involved direct or indirect 'kick-backs'. When asked "to what extent do you agree with the statement that kick backs are very popular," 62% of surveyed respondents agreed, and only 8% disagreed. One director provided an insight into the problem of kick-backs in SOEs:

"It is much better and enjoyable to work with foreign and private enterprises [than with SOEs]. They [foreign and private enterprises] are very difficult in the way that they check everything carefully before signing a contract. But after the contract is signed, all the firm has to do is to carry out the work

specified in the contract. In contrast, SOE clients always ask for 'commission'. If we do not give them 'commission' they will complain about the quality of the products we have made. But if we give them 'commission', they will accept any product, even those with not very good quality or some defects."

7.4 Areas for reform

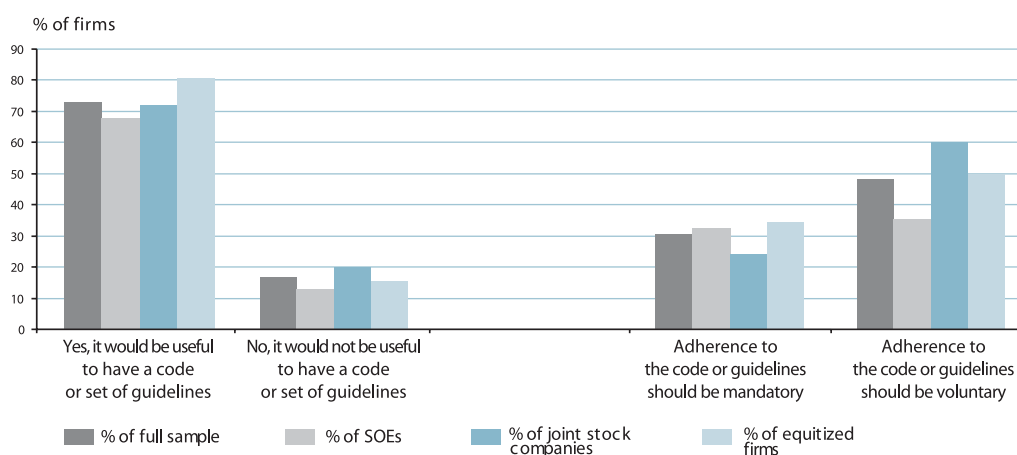
Our survey provides empirical evidence of some of the common problems related to corporate governance practices in SOEs. It is evident from the survey that the relationship between the state and SOEs is, to a great extent, incompatible with the requirements of a modern market economy. This would suggest that further SOE reform efforts are required by the government. These reforms should be focused on the separation of regulatory and ownership functions of the state with regard to SOEs, and on clarifying the roles and responsibilities of different government agencies that are directly and indirectly involved SOE governance. In addition, building capacity for government agencies and providing training on management and corporate governance for Board members, would be useful in the near term. Over the long-term, developing market institutions is probably the most effective and sustainable way to address corporate governance malpractices in the SOE sector.

8. Companies' consensus on the need to improve corporate governance practices in Vietnam

8.1 Usefulness of corporate governance

The large majority (86%) of firms we surveyed rated corporate governance as important or very important for their company, relative to other tasks; less than 3% said it was of little or no importance, with the remainder expressing no clear view. This weighting was broadly consistent across the different sub-samples of SOEs, equitized firms and joint stock companies. Almost 73% of firms thought it would be useful if Vietnam implemented a coherent code, or clear set of guidelines, on good corporate governance practices, with just 17% saying this was unnecessary (joint stock firms seemed to be the most in favor.) Of those that thought such a code or set of guidelines would be useful, opinions were mixed on whether adherence to the code or guidelines should be voluntary or mandatory, although more seemed in favor of a voluntary code (see Figure 22 below).

Figure 22: The usefulness of a code or guidelines on corporate governance



8.2 The corporate governance environment in Vietnam

The final part of the survey entailed asking the firms' representatives for their reactions to a series of subjective statements. The illuminating results are provided in the table below. Sixty percent of the sample thought the general business environment in Vietnam is not conducive to good corporate governance practices, with over half (53%) identifying insufficient legal and regulatory guidance as a constraint to better corporate governance. It was gratifying to see that only a small minority of firms (17%) thought that implementing good corporate governance was costly or time consuming, and that an even smaller number (11%) did not see much of an advantage to be derived from implementing good corporate governance.

8.3 Corporate governance as a priority area for reform

More than three-quarters (78%) of the firms surveyed thought that improving corporate governance practices should be a high priority for the government, despite the fact that over 70% of interviewees thought that corporate governance malpractices would still occur under a significantly improved set of regulations. More than half (57%) of firms did not think that the current laws and regulations provide adequate guidance on most corporate governance issues, although less than a third (27%) thought it would be highly effective to revise the existing law or introduce new laws. Initiatives that would be most effective in improving corporate governance practices, in the view of the surveyed firms, include: i) providing more training for Board of Management members and senior executives; ii) reforming the existing tax administration system so that companies are more transparent; iii) the government setting a good example; and iv) conducting an education campaign to raise public awareness.

Table 1: Perceptions on corporate governance practices, policies and constraints

DO YOU AGREE OR DISAGREE?	Strongly disagree or disagree	Strongly agree or agree	No view	
Improving good CG practices should be a high priority of the government in Vietnam	78	5	18	
Most CG scandals will still occur, even if CG regulations and practices are significantly improved	71	19	11	
In general, pursuing good CG practices is not a high priority for most companies in Vietnam	60	15	25	
In general, the value and benefits of good CG practices are recognized by most firms in Vietnam	42	26	32	
In general, the basic concept and principles of CG are understood by most business people in Vietnam	21	42	37	
In general, most private firms in Vietnam adopt good CG practices	20	41	39	
The current laws and regulations on CG issues in Vietnam are adequately enforced	18	47	35	
In general, most SOEs in Vietnam adopt good CG practices	12	55	33	
The current laws and regulations in Vietnam provide adequate guidance on most CG issues	12	57	32	
IN WHICH AREAS DO THE MOST FREQUENT CG MALPRACTICES OCCUR?	Many	Some	Very few or none	No view
Inadequate role and performance by the Inspection Committee	32	28	17	24
Poor company disclosure and lack of transparency	31	35	16	18
Related party transactions and conflicts of interest	25	38	19	19
Inadequate role and performance by the Board of Management	21	41	18	20
Inadequate role and performance by the company's senior management	13	49	20	18
Unfair or unequal treatment of shareholders	11	31	27	32
WHAT ARE THE MAIN FACTORS CURRENTLY CONSTRAINING BETTER CG PRACTICES IN VIETNAM?	Total sample	SOEs	Non-SOEs	
The current business environment is not conducive to good CG	60	58	61	
Insufficient legal and regulatory guidance on CG	53	48	56	
Companies have insufficient information and knowledge on CG	48	52	46	
Companies generally have other, more immediate priorities than pursuing good CG	27	19	32	
Implementing good CG can put a company at a disadvantage with its competitors	25	16	30	
Implementing good CG can be costly and/or time consuming	17	16	17	
Companies do not see much advantage to be gained from implementing CG	11	10	11	

IN WHICH AREAS SHOULD THE GOVERNMENT FOCUS IN IMPROVING CG PRACTICES IN VIETNAM?	High priority	Some priority	Low or non-priority	No view
Improving the role and performance of senior managers	46	25	11	19
Improving the role and performance of the Board of Management	41	24	14	21
Improving standards of company disclosure and transparency	39	31	10	20
Improving the role and performance of the Inspection Committee	38	28	13	21
Preventing related party transactions and conflicts of interest	26	26	26	22
Improving the equitable treatment of shareholders	14	33	27	26
WHAT DO YOU THINK WOULD BE MOST EFFECTIVE IN IMPROVING CG PRACTICES IN VIETNAM?	Highly effective	Effective	Ineffective	No view
Provide more training for senior managers of Board of Management members on CG practices	53	33	2	12
Reforming tax administration so that companies are more transparent about their financial situation	52	28	2	18
The government setting a good example in the way it manages economic and business affairs	49	27	4	20
Conduct an education campaign to raise public awareness on CG practices	47	38	4	11
Stricter enforcement of existing laws and regulations pertaining to CG	34	49	1	16
Disseminating a government-approved company charter 'template' which companies could use	34	39	9	18
Establish a centre for the promotion of CG	33	33	15	19
Introduce more, or revise existing, laws	27	46	10	18
Introduce a tax amnesty scheme on past taxes for companies that meet a set standard of CG practices	26	34	22	18
Introduce incentives for companies that display high CG practices	25	53	8	14
Introduce an award system for companies that display high CG practices	22	52	12	14

Recommendation

4 CHAPTER

1. Overview

Based on the survey findings outlined in the previous sections of this report, we conclude with some policy-oriented recommendations to promote better corporate governance practices in Vietnam. These are broadly divided into regulatory and non-regulatory proposals. Before doing so, however, it should be recognized that the concept of corporate governance is a relatively broad one, and that it often seems to mean different things to different people. Also, in Vietnam, the concept is not well established or well understood. An all-out campaign by Vietnam to promote good corporate governance practices could require considerable claims on limited resources. It would probably be better for policymakers to identify specific issues within the broad umbrella of corporate governance where: i) there is the most pressing need for intervention and ii) the optimum gains of such interventions - or the returns on investment of effort - could be readily achieved.

1.1 Areas for further research

As this is the first survey of its kind in Vietnam, we deliberately 'cast our net' widely, and tried to span most, if not all, of the corporate governance issues that one finds in the existing literature. In doing so, we hope we have been able to identify: i) some of the specific areas where there is greater need for interventions and initiatives; and conversely ii) some of the specific areas where existing laws and regulations are relatively robust and therefore need much less attention - to develop a baseline survey, if you will. But there is clearly a need for further, more focused diagnostic studies leading on from this initial foray. In particular, it would be worth taking a closer look at the more specific corporate governance problems faced by the SOE sector, such as potential conflicts of interest, related party transactions, and the rather confused director structures. Also, in the case of the non-state sector, other topics that would benefit from further research include the apparent weaknesses of Inspection Committees in many private firms as well as the considerable overlap that exists between

senior executives and Boards of Management. Deeper insights on these issues could then serve as useful inputs in the conceptualization and design of a focused corporate governance 'action plan' for Vietnam.

1.2 Focus on SOEs - for now

It is worth stressing that the large majority of companies in Vietnam remain small enterprises. Notwithstanding their future growth and sustainable development prospects, which depend partly on good corporate governance, their immediate need to improve such practices is clearly limited. Therefore, any efforts to improve corporate governance standards in Vietnam should almost certainly focus, at least initially, on larger business entities, the majority of which - but certainly not all - tend to be SOEs. As the private sector in Vietnam matures and burgeons, doubtless more non-state firms will develop into large corporate entities. But at present, it may be advisable to focus particular attention on SOEs.

1.3 Continue with equitization

In this regard, the pursuit of better corporate governance practices converges with the ongoing equitization campaign, particularly as the latter process shifts into higher gear and includes some of the largest enterprises in the state sector. Evidence that SOEs destined for equitization have introduced and are implementing good corporate governance practices will be a critical factor in attracting those investors, particularly the institutional ones, needed to make their divestments a success. Investors will be willing to buy shares of partially equitizing SOEs at valuations acceptable to the government only if there are improved corporate governance standards that better protect the interests of minority shareholders. As our survey results suggest, the equitization process does seem to be a vehicle for advancing good corporate governance standards within firms. This synergy provides Vietnam with a window of opportunity to push forward with the adoption of better corporate governance standards and practices.

2. Regulatory issues

2.1 Areas for reform

Our survey results suggest several areas for improvement in existing (or future) laws and regulations that deal with corporate governance issues, standards and practices. These include: i) greater disclosure requirements for Board of Management members and senior executives of firms; ii) greater clarification on the concept of the 'fiduciary

duty' so that Board of Management members and senior executives of firms are more cognizant of their legal roles and responsibilities; iii) strengthening of the Inspection Committees' authority so that they can better perform their assigned duties; iv) strengthening and better protecting shareholders' rights and equitable treatment, particularly for minority shareholders; and v) clearer and more stringent regulations to thwart related party transactions and avoid conflicts of interest. All of the recommendations were provided to the drafting team of the new Enterprise Law and were incorporated to some extent in the final law that was passed by National Assembly in late 2005. The recommendations are still relevant, however, to other existing related laws or new laws and regulations, e.g. the securities law, pertaining to corporate governance.

2.2 Resolving the agency problem

It would also be useful to introduce regulations that govern and help promote performance-based remuneration schemes, such as stock options, which better align the interests of senior managers the company's long-term success. They can encourage managers to implement strategies that will generate sustainable corporate profits and deter them from seeking to extract value from the company illicitly for personal gain. Such stock option schemes are quite common in many countries and foreign companies, but still rare in Vietnam, at least formally.¹⁵

2.3 Issues particular to SOEs

With specific regard to the SOE sector, there is clearly a need to better clarify and separate the regulatory and ownership functions of the state. There is also a need to better clarify and delineate the roles and responsibilities of those government agencies, and their mandated representatives, that are directly or indirectly involved in the governance of SOEs. Ultimately, one would wish to see the same laws and regulations on corporate governance issues relate to both SOEs and non-state firms, in as much as this is possible.

2.4 Implementation and enforcement

Needless to say, the usefulness of regulatory and legal changes that are intended to improve corporate governance standards and practices in Vietnam is contingent upon effective implementation and enforcement. Given the capacity constraints of the agencies and institutions responsible for these functions, this important precondition needs to be kept in mind, particularly when drafting new policies, laws and regulations.

¹⁵ Also see 'Introduction to Issuing Employee Stock Options in Vietnam'.

Clearly, there is a need to devise legal and regulatory interventions that are not only appropriate to Vietnam's current and specific needs, but are also practicable and 'implementable'. Conversely, the wholesale adoption of corporate governance laws and regulations from other countries, particularly the advanced industrialized economies, is unlikely to meet with much success. One leading expert has cautioned against

"importing governance structures or systems from foreign jurisdictions. Countries and corporations are best advised to start from where they are and to build on their existing structures and systems. Convergence is taking place, but it is convergence on standards of corporate governance, not necessarily on their form." ¹⁶

This broad statement seems highly pertinent to the specific case of Vietnam.

2.5 Lessons from other countries

That said, there is much that Vietnam's policymakers and advisors can learn from recent experiences in promoting improved corporate governance practices in other developing Asian countries, as well in as the transitional economies of the former socialist bloc. They provide a relevant 'smorgasbord' of corporate governance interventions from which Vietnam, with the support and assistance of those members of the donor community with expertise in this field, can select those that seem most appropriate and effective. This is also true for non-regulatory initiatives, as discussed below.

3. Non-regulatory issues

3.1 A multidimensional approach

While there is clearly room for improving the policy, legal and regulatory framework in Vietnam so as to support the enactment of better corporate governance practices, the imposition of such measures alone will not be sufficient. The ability for companies to bypass laws and regulations, largely due to the capacity constraints faced by government institutions in enforcing them, means that a more multidimensional approach needs to be adopted.

¹⁶ Sir Adrian Cadbury in the foreword to 'Corporate Governance and Development', p. vi.

3.2 Raising awareness of the benefits of corporate governance

If it is widely perceived that new laws and regulations to promote better corporate governance practices just end up creating additional (and unnecessary) burdens for companies, then their effectiveness will be limited. Rather, in a bid to gain maximum traction, it is important that any drive to improve corporate governance practices seek to illustrate why the pursuit of better corporate governance practices can be of genuine and practical benefit to companies themselves. Anything less will run the risk of becoming a cynical exercise in box-ticking at best, and possibly mass avoidance at worst. But if managers of firms can see that improved corporate governance practices will lessen their exposure to various operational risks and improve business performance, and if shareholders can see that improved corporate governance practices will permit their investments to create greater value, then new laws and regulations are more likely to be embraced and genuinely internalized in the day-to-day operations of companies. This logic suggests that a consciousness-raising and advocacy campaign would be a useful complement and support to any regulatory initiatives.

3.3 Integrating corporate governance efforts with broader reforms

It also should be recognized that making substantive advances on some elements of the corporate governance agenda can not be done in isolation from other initiatives. Rather, any drive for better corporate governance practices needs to be an integral part of the wider economic reform and business liberalization process, whether it pertains to SOEs, equitized former SOEs, or private firms. On the specific issue of corporate transparency, for example, it is hard to envisage how companies will make major strides to improve the quality of their financial reporting without a marked improvement in the corporate income tax system. It also needs to be recognized that the corporate governance challenges facing SOEs tend to differ from those of most private companies, and arguably differ again (in some ways at least) from those of equitized former SOEs. Consequently, any concerted initiative to improve corporate governance practices across Vietnam's corporate sector would need to be multi-pronged.

3.4 Institutional coordination

For the same reason, we suggest that any concerted initiative to improve corporate governance practices in Vietnam will require the combined efforts of multiple government agencies and other relevant organizations, spanning: the Ministry of Finance, the Ministry of Planning & Investment, the State Securities Commission (SSC), the Ministry of Justice, the Vietnam Chamber of Commerce & Industry (VCCI), the Vietnam Association of Financial Investors (VFAI), some business associations, and so on.

3.5 Other initiatives

In addition to supporting the policy and legislative interventions that are intended to strengthen the legal and regulatory framework for corporate governance, there is a need to support such efforts with a range of other initiatives, including: i) advocacy work in promoting good corporate governance practices within the business community; ii) the provision of education and public awareness campaigns; iii) the provision of practical training on specific corporate governance themes and issues (e.g., auditing and accounting) for senior executives and members of both Boards of Management and Inspection Committees; iv) work to deepen the pool of qualified and capable individuals who can serve as members of Boards of Management;¹⁷ and conceivably v) work with commercial banks and a credit scoring agency that can promote better corporate governance practices while also providing better access to finance.¹⁸

It is likely that different agencies or organizations would be asked to take the lead (and provide the principal inputs) on each of these non-regulatory initiatives, but as part of a relatively integrated and coordinated program. At this stage, the optimal approach would probably be to coordinate all such activities through a large-scale corporate governance initiative with multiple objectives - from raising awareness, to providing training, direct technical assistance, and capacity building for existing local institutions. In this regard, the IFC's large-scale corporate governance technical assistance work in Eastern European transitional countries serves as an approach that Vietnam might wish to consider following in its pursuit of improved corporate governance practices.

17 There is little utility having Boards of Management if the members are not sufficiently skilled to perform their duties adequately. This capacity constraint is not uncommon. In 2003, Singapore found that a boom in initial public offerings had resulted in a shortage of board directors, with some individuals sitting on ten or more company boards (in addition to their full-time jobs). See The Business Times (Singapore), 19 November 2003.

18 A far better option than providing fiscal incentives to firms that pursue good corporate governance practices.

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