

# BUSINESS ISSUES BULLETIN

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## EFFECTIVE IMPLEMENTATION: the next step for the new Enterprise and Investment Laws

The Enterprise Law and Investment Law, two key reforms which were promulgated last November, came into effect this July. Major objectives of these laws include expanding the freedom for people to conduct business, promoting private investment, strengthening the system that monitors business compliance, and creating a level playing field for businesses across all economic sectors. To achieve these ends, the government has recently issued implementing decrees and set up a Taskforce to oversee their implementation.<sup>1</sup> However, the business community continues to be concerned that, as is often the case in Vietnam, the practical implementation of laws and decrees can be inconsistent from the laws themselves. This bulletin discusses a number of concerns that remains among the business community, and discusses their recommendations on how the government can more effectively implement the two laws to achieve their objectives.

### Business freedom

In principle, the two laws aim to reduce restrictions on doing business in most sectors except those that are prohibited or restricted. In practice, however, some government agencies are still using licenses and conditions as state management tools. While there have been several efforts in recent years to streamline the business licensing regime, these have continued. Business owners are concerned about the lack of clarity regarding numbers and forms of licenses and conditions, which often entail complicated and arbitrary administrative procedures.<sup>2</sup> Both foreign and domestic businesses have been calling for a stronger government mechanism to control the quality and implementation of business license regulations. Such a process would include a frequent review of the current stock of business licenses and also control the flow of new ones, thus ensuring that the principle of business freedom would actually be respected. This responsibility has now been assigned to the Taskforce; however, as the experience from 1999 suggests, it may be hard for the Taskforce to have much impact, as the issuing agencies (mainly Ministries) hold more power and may resist cancellation of any of their licenses.

### Investor entry and compliance

In theory, the new laws should make investment easier, investment licenses are now required only for large projects and the licensing process has been decentralized to the provincial level. However, under Decree 108, most new projects (both foreign and domestic) will now have to be registered with the investment authorities.<sup>3</sup> As it is unclear how this new registration procedure will actually be executed, some investors are concerned that this lack of clarity may be a barrier to investment. In order to ensure that the process is simple and transparent, they believe that more detailed guidelines may be necessary. For the government, the additional registration procedure may impose a burden of paperwork on the investment authorities, and decentralization raises an urgent need to strengthen the institutional capacity of the provincial agencies.

However, when it comes to ensuring i) that investors in Vietnam comply with their commitments, ii) monitoring project implementation, and iii) assessing business performance, governmental agencies currently rely largely on periodic reports from investors and businesses. There is clearly a need for a stronger and more effective monitoring system especially for projects that

may have a strong social impact on communities.<sup>4</sup>

### Encouraging private investment

In recent years, the Government has publicly encouraged private investment in many different areas of infrastructure, but as there is no legal framework for this type of investment, it is unclear how serious it is.<sup>5</sup> There have been some privately-funded projects in key sectors such as power, ports, telecommunications, and oil and gas, mostly in the form of build-operate-transfer (BOT) or business-cooperation contracts (BCC); however only a few of these have been considered successful. Even now, after the new Investment Law has taken effect, investors are still unsure which sectors will allow private participation and investment and which will not. A more effective legal framework for private sector participation in infrastructure would encourage more investment and activity in such projects.

Both local and foreign investors are currently hoping that the new BOT decree will be the first of several steps towards a clearer legal framework that promotes private funding of infrastructure development. The decree aims to create a transparent bidding and selection process and simplify bureaucratic BOT project startup procedures across the national and provincial government levels, thereby removing a number of key constraints to private investment in this

(Xem tiếp trang 4)



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(1) The Taskforce for the Enterprise and Investment Laws was established by the Prime Minister on 25 September 2006.

(2) The number of business licenses has increased rapidly, from 194 in 2002 to 246 in 2003 and 298 by the end of 2004. Business licenses and conditions exist in diverse forms such as professional certificates, standard conformity certificates, registration certificates, licenses, written approvals and certificates (such as tour guide certificates). Sources: GTZ-CIEM, 6 years of Implementing the Enterprise Law: Issues and Lessons Learnt, 2006 and ADB-GTZ-PMRC, Business licensing: Current status and the way forward, 2006.

(3) See Law on Investment 2005 and Decree 108 guiding the implementation of Investment Law, issued on 22 September 2006. According to Decree 108, all foreign investment projects with capital over VND 300 billion, and those that have below VND 300 billion and are in conditional sectors, projects below VND 300 billion and except for domestic projects below 15 billion that are not in conditional sectors will have to be registered.

(4) The recent case of the SITC Training Centre demonstrates the inefficiency of ex ante control (i.e., when the government tries to regulate businesses before conditions arise) and the ineffectiveness of the post-registration monitoring mechanism.

(5) Tony Foster, Private participation in Infrastructure, Vietnam Business Forum 2005

## Business freedom



- Cumbersome procedures for business entry and registration, local master planning, and professional, business and investment licensing can restrict people's freedom to do business. In areas such as healthcare, pharmaceuticals and legal services, which can potentially have widespread impact on the broader community, the government certainly should establish basic standards and conditions to protect the public interest. For professions

like tour guides and selling CDs, for example, it is unreasonable to require licenses and impose conditions. The problem with such licenses and conditions is that the issuing agencies use them to control businesses more than necessary, rather than as an effective tool to monitor businesses' compliance.

Currently, local governments (i.e., from provincial to commune levels), through their master planning processes, may restrict the freedom of people in their area to do business. For example, there exists a commune-level plan that limits the number of pho restaurants on each street. In Mui Ne, a tourist area where many luxury hotels and resorts operate, there are no dance clubs simply because the province's master plan does not allow them! There is an urgent need to abolish these kinds of unreasonable constraints to business.

Mr. Vu Thanh Tu Anh, Research Director  
Fulbright Economic Teaching Program



- It is unfortunate that the proposed decree on State management of business licensing has been dropped; its adoption would have dramatically improved the transparency of business licensing. Although the proposed decree may have appeared to impose a paperwork burden on Government agencies, in the long run, it would have reduced that burden by standardizing and limiting the process for

establishing licensing requirements. Of course, the decree would also have benefited businesses by promoting a high degree of transparency.

Mr. John Davis, Legal Expert

- There is a need for a regulatory framework that states the conditions under which licenses will be issued and that does not leave space for discretion. The current process is cumbersome and uncertain due to its lack of clarity and excessive discretion; a simplified and clearer issuance policy would be helpful and encourage investors.

Mr. Oliver Massmann, Partner & International Lawyer  
Baker & McKenzie, Hanoi

## Investor entry and compliance



- While the Enterprise Law 2005 adopts the principles of an ex post system and aims to minimize licensing requirements, strengthen the post-registration monitoring system and enforce business reporting, the new Investment Law, through its more specific, recently-issued implementing decrees, tries to maintain the traditional ex-ante approach to control business entry by imposing an additional investment registration procedure (for foreign investment projects below 300 billion VND) and requiring that projects over

VND 300 billion undergo an investment appraisal and obtain an investment license.

Even though this is an improvement over the old regulatory framework for investment, the government should have asked the question as to what purposes these additional procedures serve and whether these controls actually help monitor investor compliance with investment license commitments throughout the duration of projects. The recent case of the SITC English training center, which has been in the papers the past few months, clearly demonstrated the flaws of the traditional ex ante approach: after issuing licenses, the state could not prevent SITC from setting up several branches across the country, could not monitor SITC's failure to comply with financial reporting requirements, did not know that SITC had not paid its teaching staff and had misappropriated the tuition fees of over 30,000 students in 21 provinces! Other recent, well-known examples of this ineffective ex ante approach include the cases of the Hanoi International School and Asia University.

It would be great if additional investment registration requirements helped safeguard creditors' interests (and those of other parties, such as employees and students), protected our natural environment and encouraged technology upgrades. The state has had enough time to assess the effectiveness and efficiency of its ex ante control mechanism, as it has been in effect for the last 20 years. Isn't it high time for the state

to consider better alternatives for managing and encouraging investment? It is worth it for everyone to reflect a while before deciding whether or not to maintain this ex ante mechanism. They should consider that increasing ex ante control causes businesses, investors, and the government itself to incur additional costs. Cumbersome, ineffective and inefficient procedures increase management costs and undermine investor interests. Also, ineffective ex post monitoring tools leave room for moral hazard behavior, which can have a negative impact on the overall economy.

In my opinion, it is necessary to strengthen the ex post monitoring system and impose strong punishments, such as criminal fines, on any business that does not comply with its financial reporting obligations. In the United Kingdom, for example, official measures such as those requiring periodical audits by independent auditors, financial guarantees before project deployment, and insurance policies for projects with a potential environmental impact are more effective than appraisals or assessments. The ultimate objective of reforming the legal framework for investment should have been to strengthen the monitoring mechanism to encourage higher quality investment projects that contribute to economic growth as well as preserve Vietnam's limited natural resources.

Mr. Pham Duy Nghia, Head of Business Law Division  
Law Faculty, Vietnam National University

- Government agencies currently tend to tighten their control over business entries. They design administrative procedures to involve more intensive "pre-checking" (i.e., scrutiny over a business even before it starts operations). The logic of administrative authorities seems to be based on strengthening government agencies' power rather than protecting and facilitating the legitimate rights and needs of businesses and the public. Nothing could be more wrong a truly business-friendly government should act differently. Consider the Investment Law's new implementing decree, for example. Its investment registration procedure is extremely ineffective. In reality, an investment certificate does not mean much by itself. The government can use information from such investment licenses for administrative statistics and reporting, but not for

policy analysis or the decision-making process. Moreover, it practically neglects the ex post monitoring mechanism, which is more important than pre-checking. Presently only about 25% of operating businesses periodically provide reports, and there is no enforcement mechanism to handle those that do not comply with reporting requirements. In addition, the reporting system for listed companies, which is compulsory, is not being implemented strictly. The quality of reports produced for shareholders and government agencies is still quite poor.

Mr. Vu Thanh Tu Anh, Research Director  
Fulbright Economic Teaching Program

- I think the investment registration certificate should be eliminated as it makes no sense. Although it grants the investor exclusive rights to a project, there is no guarantee that the investor has the capacity or even the intention to complete the proposed project. As a result, the current mechanism enables some investors to exploit investment licenses for profit. Anyone can dream up a so-called “investment project” to

obtaining financing, get the land-use rights, and then sell them for a profit.

Governments in other countries monitor foreign investment in the same way that they oversee domestic businesses. Foreign investors only need to register their businesses, not each project. They can get land use rights either by negotiating directly with landowners or through a bidding process. Only investors with strong financial capacity can win such bids and implement projects.

Mr. Le Net, Partner  
LCT Lawyers

- There is still no effective monitoring system in Vietnam; instead, the government focuses on controlling business entry. Unfortunately, foreign investment licensing procedures remain cumbersome; they should be simplified in order to attract more foreign investors.

Mr. Oliver Massmann, Partner  
International Lawyer, Baker & McKenzie, Hanoi

## Encouraging private investment



- The legal framework for BOT investment in Vietnam has not effectively facilitated the flow of foreign investment into infrastructure development. During the last decade, there were a number of BOT projects that failed, such as Wartsila Power Plant (a foreign BOT project) and Binh Trieu Bridge (a local BOT project). Only a few foreign BOT projects have been successful, including the Phu My 2.2 Power Project.

Project financing is a critical issue, as during any BOT project implementation, most of investors (i.e., concessionaires) need to raise funds from commercial banks and international financial institutions. To attract more BOT investment, the government should not only improve tax and licensing issues (which are also unfavorable), but also establish a legal framework that enables investors to arrange project financing. BOT investors in Vietnam currently face difficulties in persuading banks and other sponsors to grant loans for at least two key reasons: i) due to a lack of collateral, foreign-invested companies cannot raise funds from local banks, and ii) foreign banks are not allowed to grant a mortgage based on land use rights to foreign borrowers. Moreover, banks are often only interested in a BOT project so that they can sell their interest in it to a third party, but this requires approval from the Vietnamese contracting authority, which, in many cases, is the Ministry of Transportation or Ministry of Industry. This is a significant barrier to obtaining financing for BOT projects.

There are ways to improve this situation. First, BOT enterprises should be able to raise funds from different sources. In addition to bank loans, they should also be able to access funds by issuing bonds and other financial instruments in the capital markets. Second, foreign banks should have the rights to manage and sell BOT projects. In case a BOT project's financial projections fall below a bank's expectations, the bank should have the right to take over (i.e., step-in rights) and sell its interest in the project to the third party. If the local counterpart does not approve of the third party, then, provided all involved parties agree, it should be able to take over the project.

Moreover, most BOT enterprises are interested in getting the rights to develop and operate certain value-added services, but this is not addressed in the BOT decree. Investors in one project may also want to invest in additional projects in the surrounding area. For example, when building a road, they may also want to set up some gas stations, restaurants, or even (in the case of Phu My Hung) luxurious apartments nearby! Currently, because licenses to provide value-added services for BOT projects are approved on a case-by-case basis, it takes investors a great deal of time and resources to obtain them. Instead of ignoring such interests, the government should consider allowing public-private

partnerships that facilitate the development of these types of value-added services.

Another important issue is that of transferring equity participation. Investors need to be informed about which administrative procedures they will need to deal with, how long those procedures will take, and whether the “silence is consent” principle will apply if they do not receive any feedback from the authorities within a certain period of time. It may also be advisable to require the local authorities to specify the reasons for any refusals, and in such cases, the state should step in and take over the projects.

Negotiating a BOT contract requires balancing the public interest and investor profits. Government officials should have the necessary expertise and experience to achieve this. Also, to save time and costs for investors, licensing authority should be decentralized to local government levels.

Mr. Le Net, Partner  
LCT Lawyers



- The latest draft of the BOT Decree provides welcome changes and can help to encourage private investment in infrastructure development. For example, it clarifies the provision for privately-funded projects, stating that investors will be informed of approval within 45 days of submitting the relevant documents. Also, the decree permits project participants to select foreign laws as the governing law for their projects, provided that such laws do not contradict the basic principles of Vietnamese laws. The decree clarifies the provision on performance security: for projects above VND 1,500 billion, the performance security is 1%, while for projects below that amount, it is 3%. In addition, the decree exempts investors from land rents for the entire term of the project.

There is still room for improvement, however. It is still unclear what form of government guarantees, which are a major factor in the feasibility of any BOT project, will exist. The opening words of Article 38, “where necessary, depending on the nature of the contract,” are ambiguous. Furthermore, the new decree changes the provisions on legal capital: now the minimum equity for projects of 1,500 billion VND or more is 20% and for projects below that amount, it is 30%. It would be better if it were still possible for investors and authorized government bodies to be more flexible and negotiate lower percentages.

Mr. Oliver Massmann, Partner  
International Lawyer, Baker & McKenzie, Hanoi

## A level playing field for all businesses

● Economically, the transformation of an SOE into a one-member limited liability company does not necessarily change the nature of its relationship with the state (its owner). Therefore, one should not expect that its incentives change and that its performance improves. To effectively manage its shares in SOEs, the state needs to establish a State Capital Investment Corporation that has i) sufficient authority to deal with other government agencies (which used to be "administrative ownership" agencies) and ii) operates transparently (with periodic external audits).

The state has given state-owned enterprises many privileges, particularly through incentive and subsidy schemes. First, for some SOEs, the state subsidizes production inputs. Second, during the last ten years, the government has forgiven approximately VND 40,000 billion worth of bad SOE debts. Third, in terms of finance, SOEs enjoy preferential access to low-cost credit and "soft" credit from the public investment fund (Quy Dau tu phat trien). Fourth, the most common subsidy for key SOEs, including some commercial banks, takes the form of increased investment capital from the state budget. From 2001-2005, the government increased the legal capital of commercial banks by over VND 12 billion. In principle, all of these kinds of subsidies should end when Vietnam officially joins the WTO.

Mr. Vu Thanh Tu Anh, Research Director  
Fulbright Economic Teaching Program

● The main advantages of SOEs occur on a practical rather than a legal level. SOEs have better access to the government, can obtain licenses faster, find it easier to obtain loans, and, because they are monopolies, hold a lot of negotiation power.

Thus, the impact of the decree converting SOEs into one-member limited liability companies on the achievement of a level playing field between different types of enterprises remains to be seen. Although the new LLCs will be governed by the EL's provisions, they will remain linked to public bodies such as ministries, which may still provide them with certain advantages on a practical level.

Mr. Oliver Massmann, Partner  
International Lawyer, Baker & McKenzie, Hanoi

(Tiep theo trang 1)  
area.<sup>6,7</sup> However, adjustments to other regulations are still needed; for example, foreign banks are currently prohibited from accepting land use rights as collateral, which prevents them from lending to BOT investors. Also, because banks and other financial institutions cannot exercise step-in rights as a general rule and, as a result, often need to negotiate with relevant government agencies on a case-by-case basis, they are wary of financing infrastructure projects.<sup>8,9</sup>

### A level playing field for all businesses

In order to achieve a level playing field for private and foreign businesses, under the new Enterprise Law state-owned enterprises (SOEs) are in the process of being either equitized or converted into the form of one-member limited liability companies.<sup>10</sup> Once transformed, SOEs are expected to comply with the corporate governance principles laid out in the Enterprise Law (e.g., shareholders should receive equitable treatment, management boards should have sufficient authority to guide and monitor company officials, and companies should follow transparent disclosure policies).



● SOEs should have been offered more restructuring choices, such as being allowed to transform into two-member limited liability companies (i.e., as foreign-invested and privately-owned enterprises). The two-member LLC is a more flexible form of ownership than the one-member LLC, and in practice, some investors may prefer closely-held (i.e., with a limited number of owners) entities to public ones. The case of Sao Vang Farm in Thanh Hoa province is a good example of how an SOE can be converted into a two-member LLC. Unfortunately, our existing legal framework doesn't support this kind of transformation.

The State Capital Investment Corporation (SCIC) has been established to manage more efficiently the state's investment in equitized companies that are currently scattered under the administrative management of ministries and provincial authorities. In such firms, the SCIC, rather than administrative authorities, will now exercise the ownership function. However, it will take time to fully resolve one of the key issues in SOE reform: separating the state's regulatory and ownership functions in all existing SOEs, especially the large ones. We need to study further how to handle large corporations and groups, which currently report to the Prime Minister. In four years, all state-owned corporations and groups are supposed to transform into one-member limited liability companies; who will manage the state's shares in those firms? By that time, we hope that the issue of separating administrative and ownership functions will be resolved.

Vietnam is currently in the process of WTO accession and has committed to eliminate subsidies to SOEs. In order to join the global playing field with its new rules and counterparts, the government needs to review the entire context of SOE subsidies. The state's funds should only be invested in profitable firms that can survive in the new competitive arena. Poorly performing SOEs will ultimately be eliminated from the market.

Mr. Tran Tien Cuong, Director of  
Department of Enterprise Reform and Development,  
Central Institute for Economic Management

Whatever form the SOEs eventually take, however, it may just be a case of "old wine in a new bottle" if the legal framework does not clearly specify the rights and responsibilities for owners and management and/or if managers of SOEs lack autonomy regarding operations, fundraising, strategy development, recruiting and human resources; under either of these cases, the underlying business incentives for SOEs would not change and, as a result, it would be unlikely that their performance would improve.

Moreover, up until now, SOEs have been protected from competition, enjoying a number of privileges, including: direct subsidies (e.g., subsidies on production inputs, easier or "soft" credit, favorable tax rates, and lower administrative costs); preferential treatment by banks and other financial institutions; and better access to government agencies;<sup>11</sup> it has often been said that the playing field between SOEs and the private sector, both domestic and foreign, is unfair. To ensure a fair and competitive environment across sectors, especially as Vietnam joins WTO, such advantages must be eliminated and SOEs will need to operate on a purely commercial basis.

(6) The Decree on Investment in the form of Build-Operate-Transfer (BOT), Build-Transfer-Operate (BTO) and Build-Transfer (BT) Contracts, one of the implementing decrees for the new Investment Law 2005, is currently being drafted.

(7) Tony Foster, "Position paper of Infrastructure Working Group," Vietnam Business Forum, December 2005. The list of the main licenses and permits required for a recent BOT power project consists is very long, consisting of many pages. For more complicated projects, especially those involving land issues, the lists can be even longer.

(8) A step in right allows a party who has a financial interest in the success of a project (such as a bank) to bypass the original borrower and pay the contractor himself, to allow the project to continue.

(9) Tony Foster, "Position paper of Infrastructure Working Group," Vietnam Business Forum, December 2005.

(10) According to Decree No. 95.CP-2006, which was issued on 8 September 2006.

(11) Huynh The Du, Relationship between the State, State-owned Enterprises and State-owned Commercial Banks in Vietnam, 2005.