

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' (SIREN) 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.

