

Number **22**



Corporate Governance in Vietnam

The beginning of a long journey

 **IFC**
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MEKONG PRIVATE SECTOR DEVELOPMENT FACILITY

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October 2006

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Acknowledgements

This report was a team effort. The team was led by Nguyen Van Lan (MPDF) and Nick Freeman (consultant), under the oversight of Nguyen Phuong Quynh Trang. The study was conceptualized by Lan, Trang, Nick and Nguyen Dinh Cung of the Central Institute of Economic Management (CIEM), and the report was written by Nick and Lan.

The survey itself was largely conducted in the latter part of 2004, and was primarily overseen by Nguyen Van Lan. Other MPDF colleagues, including Nguyen Hanh Nam, Hoang Tuan Dung, Nguyen Thien Huong and Duong Thanh Trung and Rashmi Pendse provided comments on the questionnaire and interview strategy, conducted interviews and/or commented on the draft report.

Duong Thanh Trung provided considerable input in the data collection and analysis of the survey results. Nguyen Thi My and Nguyen Tuyet Hanh were extremely helpful in arranging interviews and logistics. The study benefited greatly from additional, valuable comments and guidance provided by colleagues from the International Finance Corporation (IFC) and World Bank, including Motria Onyschuk-Morozov, Darrin Hartzler, Peter Taylor, Cally Jordan. The study also benefited from the support of CIEM, notably when it came to identifying companies to interview. Last, but certainly not least, this survey would clearly not have been possible without the generosity shown by the senior representatives of 85 firms who took time out from their busy business schedules to participate in extended interviews. We thank all of them for their useful comments and insights.

Some of this study's preliminary and tentative results were disseminated at an international meeting on corporate governance, held in Hanoi in December 2004 and co-hosted by the Ministry of Finance, the IFC and the OECD. We would like to thank the organizers for giving us an opportunity to outline the study at this event.

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.



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