

# A SUITABLE TYPE OF INVESTMENT FUND FOR THE VIETNAM SECURITIES MARKET

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## I. IMPORTANCE OF INVESTMENT FUNDS

Among the financial institutions participating in the securities market, the presence of funds is one of the inevitable major factors. With more than 8000 mutual funds investing into stock markets around the globe, among them are leading groups of funds such as Merrill Lynch, Morgan Stanley Dean Witter, Goldman Sachs, Lazards Funds, Lehman Brothers, Kidder Peabody, Fidelity, Credit Suisse - First Boston, Bears & Sterns, Templeton, etc.... each managing hundreds of US billions of assets, we can learn one undeniable fact, the position of investment funds is extremely important to the operation of securities markets.

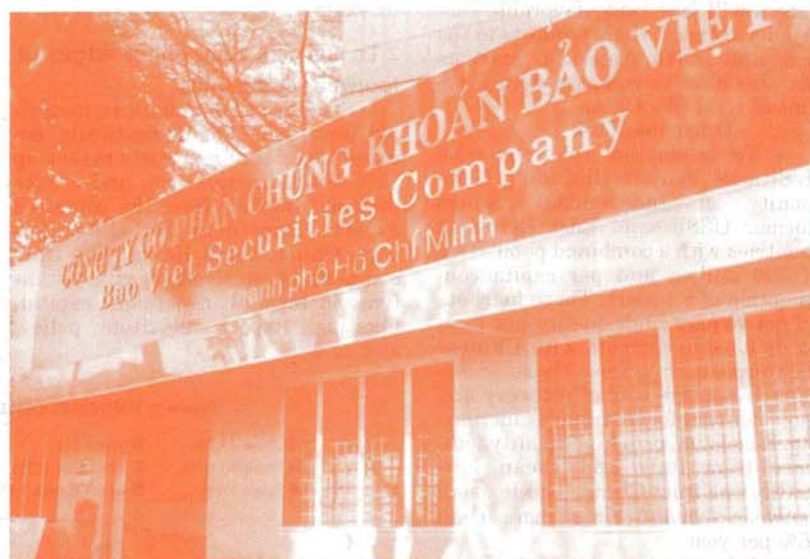
In the early stage of the Vietnamese securities market there were some funds established, but their presence is totally alien to the stipulations in the existing legal writings on securities and securities markets in Vietnam. With highly trained specialists and investment experts, the funds can not make investments as they wanted to with the level of professionalism of world standard. How can other funds and large investment institutions find a way in the Vietnamese stock markets?

## II. OBSTACLES TO MUTUAL FUNDS IN VIETNAM

Reviewing the limitations imposed by Decree 48/CP, Decree 139/CP and Decision 04/QĐ/1999, the following questions arise:

- With 30% maximum shareholding in a joint venture management company, how can the international investment institutions see their position in the Board? How do they put any considerable sum of money into the fund?

- With only 7% authorised shareholding in any issued entity, how can international funds contribute their financial strength to the fund to be established for investments. Would the SSC allow fund managers to use convertible debentures as instruments for raising money before selling fund certificates to the public?



- With the final goal of mobilizing foreign investment to meet the demand for capital, how can the fund find three different investment companies to buy in 20% of a fund? Where will the rest of the money (80%) come from? Obviously, the managers of funds in Vietnam have no experience of selling 80% of the fund (or at least 40% of the 80% domestic portion) within a short time.

- How can fund managers find a partner with only 30% shares authorised to a foreign entity, this means the foreign party will have a minority shareholding in a fund management company (FMC), which also implies that local partners may or may not agree to the investment policy proposed by the foreign experts. Definitely there will be conflict in funds operation and management

According to the regulations set by Decree 48/CP and Decision 05/1999 issued by SSC, the FMC after receiving license for incorporation can request permission to issue fund certificates. In the current situation in Vietnam, where local fund managers are unknown to investors (they have not been known in the fund management business, there is no seen or authenticated proofs such as dividends, capital gain

) how can they sell the fund shares to the public? If they invite a famous foreign FMC to join in the joint venture, again the question of shareholding in the FMC is placed on the table.

- According to international practice, an FMC sets up the fund with help from well-established financial institutions before having its certificates trade on the stock exchange. Will foreign FMC be happy to help raise the fund when they hold a minority position in the joint venture. How to adopt this practice in Vietnam depends on adjustments to be made to regulations on the stock market.

- A look at investment methods of FMC reveals that listed companies constitute important part of its portfolio. With the total value of approximately US\$24 million worth of existing shares, suppose that a volume of additional US\$70 million worth of shares will be launched into the securities markets in 2002-03, this means that foreign investors or funds could buy only 30% of the total or US\$30 million out of some US\$100 million of traded securities. This is not an attractive number to professionals if one looks into the size of capital of existing mutual funds in Vietnam.



- It's worth noting that, internationally, fund management fees vary between 1.5% to 2.5% of total assets under management per annum. Would local partners who hold from 60% to 70% of the fund agree to this common practice?

- Current law documents set no fixed fund management fees. Article 30 of Decision 05/1999 on Funds and FMC issued by the SSC only states that the levels of fees and other payment should be written in the Articles or the Memorandum of Association, no specific range of fees indicated.)

We can see from the above points, not to mention the transfer of money and profit, exchange risks (because face value of fund certificates are

US\$0.35 million to 0.7 million depending on the size of the fund and the staffs needed for running the joint venture. The Vietnamese party should hold the Chairman position and Deputy General Director during the first two to four years. The foreign party should hold the General Director position, provided he/she undergoes courses in Vietnamese laws on securities markets and a test required by SSC. Other foreign experts could be assigned the task of giving training courses in technical analysis, investment management and direct participation program after the establishment and later hold positions of Chief Finance Controller and investment operation assistants. A ratio of one foreign representative

Before the company starts operation, the whole management must meet to prepare the plans, view the situation together and reach an agreement on the investment policy, ways of implementation the policy, reporting system, decision making channel etc. Lessons drawn from well-managed fund should be learnt, analyzed and applied to the company before carrying out the plans.

## 2. FMC Board of Directors

The FMC Board of Directors must be composed of experienced managers in senior executive positions or similar experience in various areas related to the company activities. The Board should have its own by-law needed for supervising the managers, giving instructions, making adjustments to its policies in the management process, and summoning irregular Board meetings to solve problems or change directions of investment.

Relationship between the Board of Directors and the managers should be clearly and effectively designed, by which Directors only keep close watch on operations of the funds to ensure its success instead of intervening in day to day management executive works.

## 3. FMC Board of Management

Experience from some other funds in Vietnam shows that when the fund makes investment in unlisted companies, management contract should be carefully prepared for candidates for managers, regardless of their nationality. Lesson from the success of Dragon Capital Ltd. in trusting local qualified managers can help saving the operation cost thus bringing higher returns to that investment.

Researches by MPI and other authorities, including senior foreign executives show that many companies suffered losses at early stages of investment projects because they spent a lot of money in hiring foreign managers who failed to meet requirements, in some cases these losses have made the projects end in failure.

Another lesson of managing the companies invested by funds is to assign an experienced and competent finance controller or a financial manager to make regular inspections of financial situation of subsidiary companies and get periodic financial reports from the subordinates on time. Another investment expert must be assigned to visit, to assist or to give advice to the subsidiary companies'



fixed at VND10,000/certificate), repatriation tax, incentives for foreign, it is very hard to form funds with foreign participation, unless some adjustments are made to current regulations.

## III. A PROPOSED TYPE OF INVESTMENT FUND IN VIETNAM

In the following sections, we will propose some measures to improve the environment and new form of fund for Vietnam which can abide the rules and regulations with little alteration of legal writings and can be acceptable to the foreign fund managers.

### 1. Structure of fund management company

It is suggested that shareholding of the foreign party in a fund management company could be increased to 45% of registered capital. The legal capital could vary between

to three local ones at the trading floor could be sufficient.

The standing board of management must hold weekly meeting to review the investment activities made on the trading floor with the presence of the Chairman of the Board of Directors, or his appointee. Monthly investment meeting must be held to review other types of investments conducted outside of the trading, i.e. at OTC market or in newly equitized corporations, etc... depending on the portfolio the managers want to build and to change from time to time.

The General Director will have a free hand to operate according to his approved business plan and other internal regulations. All members of the Directorate of the company must contract individually with the Board of Directors for their positions, rights and responsibility.



managers on their business plan and other problems effectively.

#### IV. SOME NECESSARY ADJUSTMENTS TO REGULATIONS BEFORE THE FUND SHARES CAN BE ISSUED

As stipulated by the Decree 48/CP and Decision 139/CP, shareholding owned by the foreign party can not exceed 20% and the foreign party must consist of at least three different partners. Supposed that these entities and/or individuals incidentally share a viewpoint on an investment policy but this viewpoint is contrary to that of the Vietnamese party, will they be faced with conspiracy charges? How can the country mobilize the capital from around the world with this percentage limit? Of course, it is possible to organize Vietnamese-owned funds but fund managers need time to prove their efficiency. How long will it take?

With the current regulations set by Decision 05/1999, will the sale of fund shares be feasible when record and data of the investment fund haven't been proven and audited? Why is there no primary market for fund raising here?

We propose that two systems should be authorized:

a. Issue of fund shares could be assigned to professional investing institutions such as banks, pension funds, insurance companies, etc., then the fund is listed for sale to the public with 20% retained as required, this amount is divided according to shareholdings by institutions for approximate six to twelve months before the fund shares are sold out.

b. Underwriting is performed by Vietnamese investment institutions or by international investment banks. The underwriter can be one single institution or many institutions with the lead manager of the syndicate being the contract signature and the legal representative before the laws. Again here, 20% can be retained for six to twelve months until all fund shares are sold out to investors.

One special emphasis here is that, unlike listed companies or fixed income securities where the expected returns are known before investment is made, fund shares have no proofs of guarantee from the managers of the expected profit or return they would receive. The above -mentioned two systems aim at consolidating the investors confidence in funds. This is the reason for our suggestion because these systems make

the fund shares have the guaranteed value for trading on the floors and can be traded safely by investors

#### V. CONTRIBUTIONS TO FUNDS BY THE PARTIES

If the above two methods of fund raising are authorized, the Vietnamese partners in the management company may secure a commitment of funding or underwriting of at least 40% of the fund's initial value by Vietnamese investment institutions and other foreign bank branches, insurance companies etc. The foreign party in the management company may secure 30% allocation of the fund committed by various international investors who want to keep their shareholdings. The remaining

- Investment locations
- Investment executives & staff
- Investment methodology
- Timetable for investment and harvest.

The main objectives should be clearly defined: growth, value or balanced fund. From these strategic objectives, selected areas and methods can be decided.

The fund and the management company policy may be committed to high technology, cultural activities, technical innovation, and the environment, etc. These are criteria of investment that serve as a basis for decisions made by fund managers.

Investment areas may include: biotechnology, electronics, software, post & telecom, tourism & entertainment, housing development, training



30% may be underwritten by an investment bank arranged by the foreign party.

In the most ideal case, the Vietnamese party must secure 70% of the fund committed or underwritten, and the balance of 30% of the fund would be secured by the foreign party.

In other cases, the entire amount of the fund may be underwritten by a syndicate before launching, as suggested above.

#### VI. INVESTMENT OF THE FUND

##### 1. Investment execution

Fund managers should have a business plan prepared for the investment of the fund as a guideline for their day to day operation. The plan should include:

- Investment objectives
- Investment policy
- Investment areas - investee companies.

and educational facilities, pharmaceuticals, (especially production of traditional medicines with modern equipment)....

##### 2. Organization of the investment company

The organization of the company with the proper structure is important to the success of the operation, as it involves the instructing and reporting channel, the level of decision makers, responsibility for the safety of assets invested, trading and maintaining the portfolio for the highest economic efficiency.

A suggested model of organization of a management company in Vietnam is shown Chart 1. In this model, the FMC is composed of the following executives and subordinated sections or departments:

- The Managing Director-General



- The Financial Director (or Deputy M.D)
- The finance & accounting department
- The fixed income securities market department
- The equity market department
- The portfolio management department
- The projects screening department
- The information technology department
- The administrative & personnel department

The Managing Director- General should be in charge of the portfolio management department and the three markets and projects departments. He will have three managers assisting him in each area.

The Finance Director is in charge of the finance and accounting department and the administrative & personnel department. He is also in charge of a supervision team that carries regular inspections of investee companies in cooperation with managers appointed by the company.

### 3. Process of investment

The Managing Director will submit the initial business plan or the annual business plan detailing the areas of investments, fund allocation, timetable, expected returns, plan of execution, staffs, etc. to the Board of Directors for approval in principle. This step is done before implementation of the plan or before a new fiscal year. Full board meetings are organized quarterly near the end of March, June, September and 20 December each year for reviewing the business performance and approval of the business plan for the next quarter.

A quarterly business plan is prepared and presented before board meetings (including the FBOD and the FMC/BOD). Day to day trading and execution of investment will depend on this approved plan.

Once the business plan is approved, the Managing Director can determine to effect the portfolio with best result. The managers will receive instructions from the Managing

Director to trade or to seek for sources of the wanted securities of the portfolio.

If the company has a policy to gain some more profit from daily trading, certain amount of securities is set in the reserve for this purpose. The operation process is the same as what is adopted by other brokerage firms that engage in daily trading.

### 4. Investment in pre-IPO (initial public offering) or pre-listing companies

Reports of the projects to be invested or further supplementary documentation of the investee candidates will be prepared for the Board of Directors and Board of Management by relevant managers. Once the projects or candidates are approved by those boards, the equity market and the fixed income securities market departments would carry them out as required by their duties.

The Managing Director will decide when and how to change or add certain assets into the portfolio. ■

CHART 1: ORGANIZATION CHART OF FUND MANAGEMENT COMPANY

