

# BASIC FINANCIAL MEASURES TO IMPROVE BUSINESS PERFORMANCE OF STATE ENTERPRISES

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**B**efore 1985, the Vietnam economy is under the centrally planned and subsidized mechanism, the market and commodity economy isn't recognized.

Changing into the market economy, many state enterprises met with difficulties: goods produced couldn't be sold, many companies became defaulters. In such a situation, it's necessary to reform the system of state enterprises with a view to helping them adjust to the market mechanism. Simultaneously, the government's task of economic management must be also renovated in order to create favorable conditions for state enterprises to do, and bear full responsibility for, their businesses.

We should realize that there are a lot of contradictions in the public sector: contradiction between the task of serving the society and the task of making profit, contradiction between private and community interests... So the public sector faces a lot challenges. In order to improve business performance of state enter-

prises, the following problems must be solved:

- To create the healthy legal infrastructure in order to ensure the economic development in fair competition with clear, systematic and reasonable regulations.

- To rearrange state enterprises with a view to controlling key industries only: By doing so, the Government can be strong enough to innovate technology used in these enterprises and renovate its managing mechanism in order to make it a useful instrument for the Government to regulate the economy. Other industries could be left to other sectors.

- To reform the mechanism for economic management by forming several groups of companies, for the time being, in key industries; separate the administrative management from business management; recruit and appoint managers of state enterprises according to the statute of civil service; to connect responsibility with

interest and rights with duties; discriminate between public utility services and state enterprises looking for profit.

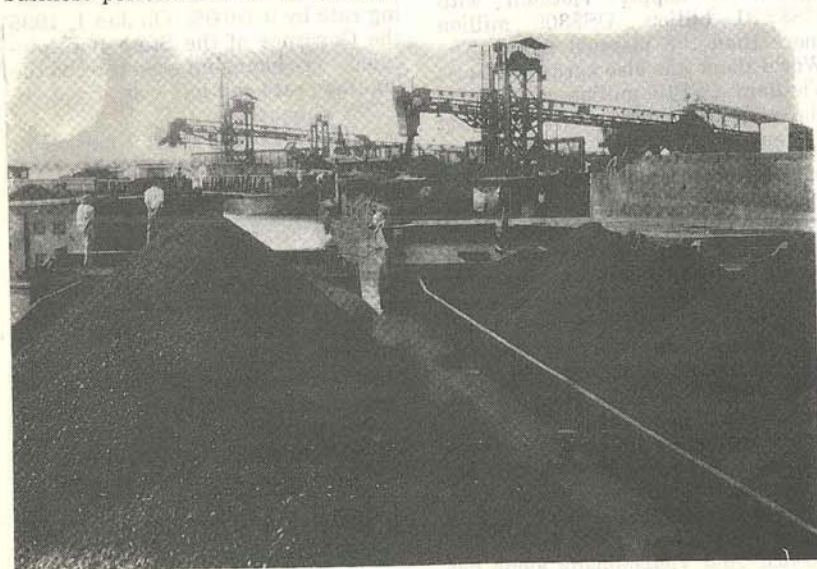
- To reform financial mechanism: the mechanism for financial control depends largely on targets set forth by enterprises. In my opinion, state enterprises supplying public utilities can be organized as unlimited companies and state enterprises doing business for profit can take form of limited companies as in other sectors.

Based on rearrangement of state enterprises in this way, financial measures to adjust them to the market economy could be set forth. These measures aim at using financial instruments to regulate or interfere in state enterprises with a view to reforming them and helping them operate and develop well. There are various financial measures such as financing, supplying soft loans, giving price support or tax incentives, making policies favorable for income distribution or investment, etc. In my opinion, for the time being, stress must be put on the following matters:

## 1. Starting capital for newly formed state enterprises

- As for new enterprises with profit motive: The Government will allocate needed capital once and for all upon its establishment. The allocated capital must be, at least, equal to the legal capital required by the Government for each business in order to enable new enterprises to operate and compete with non-state companies. Enterprises, after receiving capital from the public treasury, must:

- + Preserve and increase allocated capital: In Vietnam, the inflation rate keeps on staying at two-digit level, capital should be preserved carefully from risk because of fluctuation of prices. So in my opinion, state enterprises should be allowed to form







reserves of various kinds such as reserve for depreciation, reserve for bad debts, for risk in financial investment, etc. These reserves will be charged against gross profit of enterprises. At the end of the accounting period, if nothing happens and the money is no longer needed to be kept in reserve, it could be added to gross profit. If these reserves can't preserve the capital, we can resort to the capital redemption reserve fund.

+ Be allowed to use capital freely and legally in order to reach good business performance.

- As for rearranged enterprises: their assets should be reevaluated by an auditing company. After that, they will be treated as a new enterprise.

- As for public utility companies: they will be treated as new enterprises. If they suffer losses, subsidies will be given because they are under government control in fixing prices and using profit gained. However, these subsidies can't be limitless and the management of these enterprises should understand this.

## 2. Amortization of fixed assets

The regulation on amortization of fixed assets must be changed in the following manner: amortization rate will be fixed differently over industries in different ranges and each enterprise can choose the most appropriate rate within the range fixed. This practice can expand the autonomy of the enterprise, help it to retrieve its capital invested and buy new technology or machines faster.

## 3. Tax on capital of state enterprises

It's reasonable to remove this tax because this deed is appropriate to the present situation (direct investment), makes all companies of different sectors equal, and helps state

enterprises compete more successfully with non-state companies.

## 4. Salary scale for employees of state enterprises

As we know, in spite of successive reforms of the salary scale up to now, it is still too low to compare with basic needs and actual income of employees. Just because of this the labor efficiency has been low. In order to encourage employees to work hard many directors had to break regulations and invent a lot of allowances or incentives with a view to raising actual income of employees. Thus, this situation has unintentionally encouraged directors to go against government regulations. This is a terribly bad habit.

In my opinion, the salary and wage should correspond with title, skill and responsibility of employees. Salary should be the main income of laborers. It should satisfy basic needs of laborers and their families (or even enable them to have some savings). Incentives of all kinds are only additional source of income which encourages them to complete the job excellently.

Moreover, the salary scale should be simple and be tailored to two different kinds of employees: in administrative machinery and in economic concerns. At the same time, the personal income tax could be used as the main means of obtaining money from high income earners for running the public services.

## 5. Profit distribution

The enterprises' after-tax profit, first of all, could be used for forming three funds: capital redemption reserve, reserve for investment and fund for incentives and fringe benefits. After forming funds, 60%-80% of

the rest will be paid to the public treasury (as the dividend paid to the biggest shareholder), 20%-40% will be divided among employees of the enterprises with a view to encouraging them to work harder. The government had better not bother about additional profit tax or super-profit... I think that way of distributing profit is reasonable because it affirms the role of capital and labor in production. Moreover, it's also appropriate to the motto "efficiency, quality, effectiveness". The salary or wage is paid according to employee's efficiency and quality, and the amount of profit divided is paid for their effectiveness.

The percentage of after-tax profit put into the capital reserve is decided based on the degree of risk of each industry. In developed countries, this percentage varies from 5% to 10% but the maximum balance of this reserve is not larger than 20% compared with the working capital.

The reserve for investment is made from a percentage of after-tax profit, amortization and from sale of fixed assets. This reserve will be used for development or expansion of the enterprise.

The fund for incentives and fringe benefits will be used to award employees of high effectiveness. This award should be equivalent to 3-month payments at most. This fund could be also used for paying the 13rd-month salary at the year's end or paying fringe benefits.

## 6. Investment for development

If the enterprise wants to expand its business, and if its reserve isn't large enough, the enterprise is allowed to retain all its profit and make it investment (its feasible plans should be approved beforehand by related administrative bodies). To some extent (in development plans which the Government is forced to carry out, or the said enterprise has made big profits annually and had good effects on the local economy...), the Government can allocate more capital to plan. It isn't a subsidy but only an investment from the Government.

The reformation of the mechanism for financial management of state enterprises based on the right conception of the enterprise's organization, functions and autonomy in the national economy should aim at accelerating stable development under the socialist orientation. The above mentioned measures can only produce intended results when they are carried out in parallel with reforms in law and administrative mechanism.