PRIVATIZATION PROCESS IN VIETNAM

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Being a socialist country, Vietnam has had a transition economy which started from the late 1980s. Decision to change from a centrally-planned economy to the market one with a combination of structural reforms and stabilization measures was made when Vietnam faced a macroeconomic crisis with hyperinflation rate of some 400% in early 1989, and Vietnam's current account deficit had risen to about 10% usually offset by aid from the Soviet Union, which was collapsed (James Riedel and Bruce Corner, 1977). To escape an imminent crisis, renovation of the economy became an inevitable tendency and was assumed as a main measure to save the situation by both Vietnamese leading politicians and economists at that time.

In capitalist countries, privatization is normally considered as the process in which governments sell state-owned enterprises (SOE) to private investors. In socialist countries, however, privatization is seen as a process of establishing the private ownership of means of production in many different ways. In the transition process, although the term 'privatization' has been a taboo in Vietnam, it has taken place during the last two decades under four ways: (1) selling small and poor performance SOE; (2) facilitating foreign joint ventures; (3) equitizing SOEs, that is, allowing them to go public; and (4) allowing private concerns to be established by issuing the Companies Law in 1992 which was amended in 1999. A total of 21,234 companies and more than 20,000 family businesses were established in the whole country in the past 18 months after the Companies Law took effect. They have a total registered capital of more than VND36,000 billion (VASC, 2001). Besides selling state property through auction, the Government has carried out the privatization under private share offering, called equitization.

Equitization is defined as the process in which SOEs issue equity shares to raise fund to invest in new technology or enlarge their business operation, or the process in which SOEs are translated into corporations totally or partly owned by individuals, and other entities aimed at changing the ownership of the companies, attracting investment from the private sector, enhancing worker participation and improving business performance. Specifically, the Article 2 of Decree 44/CP dated June 29, 1998 on transformation of SOEs to corporations states that objectives of equitization are as follows:

- To mobilize capital from individuals, organizations, foreigners and foreign institutions to invest in new technology, create new jobs, enhance competitiveness of SOEs and restructure SOEs.

- To turn employees into shareholders, democratize operation management with a view to create the profit motive and better business performance. As a result, value of privatized SOEs and employees' income will increase.

The decision to equitize SOEs was made to enhance the role of the public sector in the economy because the socialist orientation of the market economy requires the dominance of the public sector in key industries. The Government has taken many measures to rearrange and reform SOEs, in which the equitization is considered as the main solution to the problem of better performance for SOEs by restructuring their ownership. The process has undergone three steps that are as follows:

+ Step 1: Sectoral and local authorities (e.g. Ministry of Industry and HCMC People's Committee) classify SOEs into three kinds: (1) profit making, (2) no loss making, and (3) loss making. The classification is based on accounting information of SOEs' performance in three years' duration before their equitization. As shown in the Table 1 below, SOEs can be characterized as having low productivity and competitiveness, serious bad debts, small scale and dispersedly location. The SOE Renewal Department reported that in 1998, some 20% of SOEs suffered continuous losses; and 40% broke even. The bad debt balance by SOEs equaled 124% of the total capital invested by the Government. Idle employees accounted for 6% of the SOEs labor force. In 1999, Vietnam had 5,280 SOE capitalized at VND106,892 billion, or VND18,425 billion per SOE. SOEs capitalized at less than VND5 billion accounted for 65.45% of the number of SOEs. Particularly, SOEs controlled by local governments had an average capital of less than VND1 billion. According to the program to arrange the system of SOEs suggested by the SOE Renewal Department, the number of SOEs will be reduced to 2,500 by 2005; the number of SOEs in which the State owns more than 30% of equity capital will be 540 units, the number of SOEs in which the State owns less than 30% will be 480 units. The Government sell 220 units and disbands 370 ones. Up to noe, SOEs still supply most of essential goods and services such as electricity, coal, cement, steel and fertilizer. SOEs dominate many industries, such as telecommunications, oil and gas, air transport and railroad. Although SOEs contribute some 40% of the GDP annually, their poor performance is a very serious problem.

+ Step 2: The equitization of SOEs next year will be based on their willingness. For example, the HCMC government planned to equitize some 30 SOEs under its control in 1999 while the Ministry of Industry wanted to equitize 11 units. In 1999, 43 SOEs controlled by the HCMC government were equitized because 13 other SOEs started equitization in 1998 and could only complete the process in 1999. To the end of 1999, the HCMC government controlled 356 SOEs including 52 public utility companies and at the end of 2000 this number reduced to 318 units with a total estimated value of VND22,384 billion (HCMC People's Committee Report, 2000).

+ Step 3: The Central Equitization Board issued the decision to equitize some selected SOEs and the equitization procedure within SOEs begins to be executed. The procedure takes three stages:

a. Preparation:

- Establishing the equitization committee,
- Informing employees of the equitization,
- Signing the auditing contract.

b. Setting up the equitization plan:

- Planning the distribution of funds for bonus and social benefits among employees,
- Determining the number of shares sold to each employee,
- Establishing a commission responsible for evaluating the SOE value and solving financial problems,
- Working out after-equitization business plan.

c. Approval and implementation:

- Getting the equitization plan approved,
- Publicizing the plan through mass media for few weeks,
- Appointment of representatives from controlling governmental bodies to the board of directors,
- Issuing shares under supervision of the Ministry of Finance that officially transfers the ownership to shareholders,
- Organizing the shareholders meeting to confirm the birth of a new corporation.

In fact, the value of SOE is determined based on the SOE's assets value at the time of equitization rather on its profitability. The land value is not included in company's assets value although most SOEs possess real estate locating in the city center such as Districts 1, 3 or 5 of HCMC where the market price of land is the highest. The determination of REE Corp. value is one of typical examples of this case. REE factory area of 40,000 square meters that was worth VND140 billion (market price) was evaluated at VND3.2 billion when equitized in 1993. Another case is Saigon Garment Company. The director of Saigon Garment Company said that the company had a factory that was evaluated at VND200 million; however, if it were sold by auction at that time, outside investor would be willing to pay VND1.4 billion.

The determination of SOE value takes a long time because it has to comply with the direction of complicated documents issued by the Ministry of Finance although most of the documents are obsolete and not suited to specific characteristics of SOEs. For instance, the evaluation of SOE value has to comply with guideline for evaluating resident housing. Another reason for the devaluation of SOEs to be equitized is the fact that the majority of buyers are insiders (managers, workers and their relatives). Of course, the buyers always want to pay less for everything they want to acquire.

Table 1: Status of SOEs from 1995 to 1997

	Unit	1995	1996	1997
Number of SOEs	Entity	6,052	6,052	5,740
– Profitable SOEs	Entity	4,710	4,440	4,400
– Loss-making SOEs	Entity	998	998	1,225
State's capital	VND billion	80,684	98,122	102,650
Workeforce	Person	2,000,000	1,734,474	1,492,264
Sales	VND billion	242,995	278,522	305,000
Before-tax earnings	VND billion	13,480	10,962	11,058
Liabilities	VND billion	120,270	100,577	119,000
– Bank loans	VND billion	57,734	44,146	41,000
– Receivables	VND billion	91,097	64,141	56,000

Source: Report by the State Investment and Planning Committee, 1997

The procedure for equitizing an SOE is too time- consuming and complicated, especially the process of the evaluation of SOE assets. Some researchers assumed that the complication has slowed down the pace of equitization because there are many different governmental bodies taking part in the process, and the unclear origin of SOEs'assets and book recording. Economists estimated that the value of SOE equitized was usually remarkably lower than its intrinsic value.

Other factor that slows down the pace of equitization is the way of solving SOE bad debts, which is very time-consuming. As a result of soft budget constraints, most SOEs have high debt ratio (DR around 0.85). The bad debts had lasted for many periods; therefore documents related to transactions might not be found and it is difficult to determine who is responsible for the bad debts because the change of the management. In addition, SOEs' low cash ratio liquidity resulted from SOEs' assets value being form of investory value. According to HCMC statistics, up to Dec. 31, 1999, SOEs controlled by the HCMC government had payable balance of VND10 billion while owners' capital was VND11 billion, and their bad debts amounted to VND300 million.

In reality, the equitization has been carried out through two stages. Firstly, the Vietnamese Government issued the Decision 202/CT dated June 28, 1992 on the transformation of some SOEs to corporations in a pilot scheme. During this period from 1992 to 1995, there were five SOEs that were chosen to turn into corporations, they were: REE Corp. (Dec. 14, 1993), Transportation Union Agent (Sep. 15, 1993), Hiệp An Footwear Corp. (1994), Long An Food Processing Export Joint Stock Company or LAFOOCO (19950, and An Phú Animal Feed Processing Corp. (1995).

After the pilot scheme was carried out, the Government decided to launch an equitization program at the national level by issuing Decree 28/CP dated May 7, 1996 and Decree 44/CP dated June 29, 1998 on the transformation of SOE to corporations. The introduction of Decree 44/CP has accelerated the program. Article 7 of Decree 44/CP states that the equitization can be carried out by the following ways:

- Issuing new equity shares to mobilize external capital for enlarging scale and improving technology of SOEs equitized,
- Transferring partly state-owned capital to individuals or other organizations,
- Equitizing some shops of each SOE if they have enough conditions for equitization,
- Selling total SOE to individuals or other organizations.

An SOE chosen to be equitized has to have some conditions that are as follows:

+ Its scale is small or medium (except SOEs that were equitized in the first form of equitization).
+ It is not the kind of SOEs that the Government wants to hold 100% of their capital.
+ It has an effective Business plan.

In order to mobilize capital from non-public sectors, the Article 3 of Decree 44/CP allows organizations, Nationals, expatriates and foreigners living in Vietnam to have the right to buy equity shares from the SOE to be equitized. The Government has also offered foreigners and foreign entities the same right. However, the Government limits the fraction owned by non-public sectors in SOE equitized. Particularly, in SOEs where the Government wants to hold more than 30% of total ownership, an individual isn't allowed to buy more than 5% of total equity shares, and an entity not more than 10%. In SOEs where the Government's stake is less than 30%, they can hold 10% and 20% respectively. With SOEs privatized that the government doesn't want to hold the ownership, the fraction owned by non-public sectors isn't limited. However, the equitized SOEs must ensure the number of shareholders as required by the Companies Law.

Outside individuals find it hard to buy shares from the privatized SOEs unless they are stakeholders of the company. Employees who work for the privatized SOE are allowed to buy 10 shares for each year of their seniority at a lower price (equaling 70% of the face value). Thus the amount of shares the employees can buy depends on how many years they work continuously for the company. However, total deductible value has to be less than 20% of the stake in the company held by the State. Poor employees can pay for the shares by 10-year installment without paying interest.

In order to encourage the privatization of SOEs, the Government offers the following benefits:

- The SOE transformed into a corporation is considered as a new investment and enjoy incentives stipulated by the Domestic Investment Encouragement Law. If not, its profit tax is cut by 50% for the first two years after its privatization.
- Total cost of equitization will be deduced from the government's stake in the company.
- Privatized SOEs do not pay register fees if they change their operations after equitization.
- Privatized SOEs can enjoy the same preferential treatment as SOEs when borrowing money from the state-run banks.
- Privatized SOEs are allowed to maintain funds for social benefits for the sake of their employees.

Share issue offering has been executed directly in the SOE headquarters, not by financial intermediaries. The share offering is private one because the State, insiders and their relatives hold a large fraction of ownership of the SOEs to be equitized. The Table 2 gives an outline of 387 SOEs being equitized from 1992 to 2000 in terms of their ownership structure and size and shows that most SOEs equitized are of small and medium size and the equitization is done by private share offering. The average stake held by the State is 23%, and by insiders (managers and their relatives) 61%. For example, the director of REE Corp. holds 51,614 stocks and her husband 115,951 ones, totally accounting for 11% of the number of stocks issued.

Table 2: Capital and Ownership Structure of 387 SOEs Equitized from 1992 to 2000

	Mean	Median
Capital (VND mil.)	5,695	3,027
State-owned proportion (%)	23	24
Employee-owned proportion	61	60
Outside investors proportion	18	10

Source: Report by the SOE Renewal Department 1999-2000

In short, it could be assumed that the equitization through private offerings is die to three reasons: (1) there is no well-organized capital market in Vietnam (the HCMC Stock Exchange Center didn't come into existence until July 2000); (2) the Government didn't want to give up SOEs and gave preference to insiders when selling shares, and (3) most equitized SOEs are of small and medium size. HCMC Stock Exchange Center allows only companies with capital of at least VND30 billion to list their stocks. Ninety percent of equitized SOEs have capital below VND30 billion. That is why the chance for outsiders to invest in privatized SOEs through initial share offeribng is very small. The only way for them is to buy stocks from poor workers or insiders.■