

Unnecessary Competition for Issue of Government Bonds

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From Jan. 1, 2006 on, issues of government bonds by branches of the National Treasury was sopped, so these bonds could only be issued by two ways: by underwriting and by tender. Existence of two issuing practices with different procedures and regulations has led to a keen competition between them. The unnecessary and unreasonable competition produces an absolute advantage for the underwriting practice causing waste of money for the National Treasury and difficulties for issues of bond by tender. Authorities must examine strengths and weaknesses of those two procedures in order to choose the right one or review the issuing plan in order to avoid unnecessary competition in favor of the issue by underwriting when bonds are sold by both two procedures at the same time. Results of issues of the government bonds in the years 2000-06 may show us the said unreasonable competition.

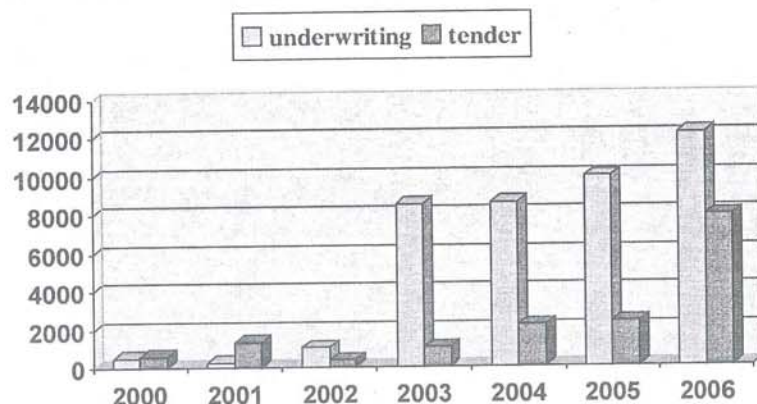
In 2000, some VND600 billion worth of government bonds was issued by tender in five trading sessions while value of bonds issued by underwriting reached only VND500 billion, VND100 billion lower than the proceeds gained by issue by tender on the

stock market. Percentage of borrowings in the issue by underwriting came to the lowest level – 2.93%; while the borrowings in the issue by tender was 3.6%. They were two ways of issuing bond with the lowest borrowing percentage in 2000.

In 2001, the issue by tender was both competitive and non-competitive (non-competitive purchase is to buy bonds at awarded interest rate after tendering), results of the tender was based on the awarded interest rate instead of comparison of the amount offered and the amount awarded as done in 2000. As for tender session in which the interest rate offered was lower than the rate ceiling but the amount accepted was smaller than the amount offered, it could be seen as the awarded session with the amount awarded lower than the amount offered during the issue. The amount of bonds unsold would be offered at the next session. This could be considered as a reasonable adjustment for tender sessions, which increased the amount of bond awarded and 12 sessions were held successfully this year. These sessions were held continuously and the value of awarded amount of bonds reached VND1,333 bil-

lion equaling 39.2% of the value offered and 63.6% of the valued tendered. The value of bond awarded was 2.22 times higher than the valued gained in 2000. Moreover, result of the issue by underwriting fell be 50% as compared with 2000 and the amount underwritten was worth only VND250 billion. Percentage of borrowings experienced no improvement as compared with 2000. Borrowings in the issue by tender reached 7.61% and ones in the issue by underwriting reduced to 1.43%. Thus, in the years 2000-01, the result of the issue by underwriting is lower than one of the issue by tender through the stock market. This situation is easy to understand because the stock market just came into being in July 2000 and most investors were not numerous enough and they tended to study carefully before making decisions. In addition, The issue by underwriting could not gain good results because only a few organizations has enough conditions to act as underwriters, participants are usually state-owned commercial banks but they didn't have enough disposable capital to take part in underwriting.

In the years 2002-06 the issue by underwriting always produced much better results in comparison with the issue by tender. The value of bonds issued by tender through the stock market was VND13,847 billion while the issue by underwriting brought about VND40,302 billion –three times higher than the sum gained by the issue by tender – and led to a much higher percentage of borrowings. Although the issue by underwriting made good progress in that 5-year period (the volume of bonds issued rose



by some 10 times) but it was almost under control of some powerful investors. In fact, bonds were issued according to their agreements and there was no competition like the one between investors on the stock market. Issuers tended to hold back the bonds instead of sending them to the market, which produced bad effects on development of the stock market.

The issues of bond by underwriting alternated with issues by tender on the stock market and the former competed keenly against the latter. The underwriting fee was set at 0.15%, which encouraged financial institutions to concentrate on the underwriting instead of tendering for bonds of the same maturity and interest rate on the stock market. The best part of bonds issued by underwriting is from local governments, therefore the interest rate and underwriting fee are usually higher than cost of the tender, which means more expense for the public funds.

Issuing by underwriting such low-risk securities such as the government bonds when the issue of bonds by tender is meeting with keen competition becomes unreasonable. Presence of underwriters is only necessary when issuing high-risk securities (such as company shares or bonds) or issuing government bonds on foreign stock markets. Alternating the issue by tender on the stock market with the issue by underwriting will give an advantage to the latter and reduce results of tender sessions, which will hinder the development of primary and secondary markets for the government bonds, and the development of the whole stock market as well.

Although both procedures for issuing the government bonds have the same objective, there is competition to a certain extent between them. Investing



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short-term capital in tender sessions will certainly affect the investors' long-term capital used for investing in bonds. Underwriting brings underwriters in more income from the underwriting fee than taking part in tender sessions in the stock market because investors can not be certain that they will be awarded, and if any, they can only get some interest at the awarded rate. Meanwhile, if they act as underwriters they can get the interest and underwriting fee of 0.15% even if the bonds are not saleable and they should buy them all. Moreover, reality shows that most underwriters, especially ones who are commercial banks, tend to hold the government bonds as investments instead of selling them to the public. This reason makes tender sessions in the stock market have less participants and lower results in comparison with underwriting session held at the same time.

By analyzing numerical data and estimating unreasonable competition between the two procedures for issuing the government bonds, financial authorities had better take measures to deal with this competition thereby en-

couraging a healthy development of the market for bonds and the stock market as a whole. The following are some desirable measures:

- Firstly, the issue by underwriting should not alternate with the issue by tender in the stock market in order to reduce the unnecessary competition between them because this practice always put the latter at a disadvantage.

- Secondly, the issue by underwriting is only used for securities riskier than the government bonds and for issuing these bonds in foreign stock exchanges (not for issuing the bonds in the local market.)

- The issue by underwriting could be only considered as an urgent measure to sell the government bonds when the government needs a large sum of money and other procedures for issuing bonds are not effective enough. At present, when the local stock market is in its first stage of development, financial authority had better stop employing this procedure so frequently and try to issue them by tender with a view to turn the government bonds into a leading commodity in the stock market. ■