For a Corporate Governance in Small and Medium Enterprises

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One of the biggest challenges that SMEs in Vietnam is facing now is how to sedure capital for their investment aims and expanding their scope of operation.

After the Companies Law, number of newly- established small and medium enterprises (SMEs) has been rapidly increasing. Existing SMEs have expanded its production scale. As a result, shortage of appropriate capital has become one of the three leading obstacles to companies. Bank loans, if any, are mainly the short-term . ones. Hence basically these loans just meet the need for working capital, not for capital investment in the company (e.g. investment on new technology...) However, professional investors in Vietnam (both individuals and institutions, domestic and foreign investors) are willing to put their money in local SMEs in a long-term basis. After withdrawal or being content with small investments only for some time due to the sombre market in Vietnam, foreign investment funds (Dragon Capital, Mekong Project Development Fund...) are now one by one coming back to Vietnam seeking for opportunity to invest in privatized state-owned enterprises (privatized SOEs) listed on the stock exchange or in local SMEs, depending on their own strategy. Local banks and corporations have also established their own funds to invest in potential SMEs (VinaCapital, Vietnam Opportunity Fund...).

Although these SMEs are in need of funds for their development, the actual amount of mobilized capital is not as much as they are expected. One of the reasons that prevent these SMEs from getting access to the professional investors is that they do not have the good corporate governance. These SMEs usually started from small- scale family businesses. At first their performance is acceptable thanks to their small size, then everything becomes beyond control of the owners when the business gets growing.

At this stage, the owners have to seek for capital financing from banks or outsiders. However, banks as well as outside investors are hesitant to invest in these SMEs because of such risks as the lack of effective internal control system, lack of protection for shareholders' rights and the absence of financial transparency and disclosure, etc.

Such internal risks of SMEs make banks apply higher interest rates on loans, require more valuable mortgage or simply refuse the loans. Investors may impose lower valuation on the company or in the worst case, not put investment in the company.

Companies which meet good corporate governance standards usually have better chance to approach the better financial funds with lower costs (e.g. lower interest rate or higher company valuation) compared with ones that have ineffective corporate governance. The better the corporate governance, the higher the valuation (that means the P/B is high) and the higher the performance indexes (e.g. return on capital employed - ROCE - is higher) and as the result they can bring higher returns for shareholders.

If the company owns a good information system, ensures transparency and disclosure of its financial statements, it can make the examination and valuation process of company become more quickly and easier for both banks and independent investors. This will also help reduce operating cost of banks and independent investors, which thenceforth helps company get access to funds with lower interest rate (if lent) as well as lower expectation on profit (if invested).

So what is exactly the good corporate governance? What definitions of corporate governance require and how to maintain good corporate governance seem quite diverse and various.

However, good corporate governance could be generally defined as "procedures and structures by which a company is directed and controlled for the purpose of increasing long-term value of shareholders by the improvement in its business operation performance and its responsibility to shareholders and society." Corporate governance does not relate to the day- to- day management of the company, other than defining the rights and responsibilities of the management. Besides this general definition, good corporate governance gives clear definitions of rights and responsibilities of members in company, including shareholders, board of directors, managers and related parties, which are as follows:

- Defining rights and responsibilities of shareholders, including minority ones: For example, it sets up equal treatment for new share issues or share buybacks; voting, dividend payment and liquidation rights;
- Defining rights and responsibilities of the board of directors: A fair system of nominating and electing members of the board of directors and board of inspectors should be established. Articles of incorporation must points out minimum qualifications for the Board members, especially the potential conflicts of interest, the ability to perform their duties...
- Defining rights and duties of the board of inspectors: In addition to ones stipulated in the Companies Law, some others should be made clear such as measures to check how the board of directors and directorate obey the law and resolutions made by the general meeting of shareholders; examine the business performance and management; supervise major expenditures, acquisitions and withdrawals; monitor potential conflicts of interest of the board of directors, Directorate and majority shareholders; and ensure the effectiveness of corporate governance and internal control system.
- Presenting clearly company regulations on transactions between relevant parties to avoid potential conflicts of interest that may cause loss or damage for the company.
- Establishing company regulations on information disclosure and

financial transparency: Besides accounting reports under Vietnamese Accounting System, company should disclose other financial statements on a quarterly basis to shareholders and annual financial statement should be audited by an independent auditing firm.

- Disclosing ownership and control of shareholders, especially by majority ones: This is extremely important to shareholders since they should have the information accurately, adequately and timely in order to make proper decision on acquisitions or sale of shares.

Of course the above-listed items could not be adequate since definition of the good corporate government varies from country to country. Some definitions also mention to other parties such as employees, environment and social responsibility of the company.

There is no universally- accepted model of the good corporate governance. Each country has to seek for the most appropriate model that matches its own requirements so that its model could function effectively. Although principal models are almost all alike, codes and relevant laws pertaining good corporate governance applied in United States and United Kingdom are very much different from those in Germany and Japan. This difference is caused by the differences in business environment, shareholder and corporate structure, accounting system ... And even cultural and historical issues may also make an important contribution to the formation of the good corporate governance. Therefore successful good corporate governance practices in one country could not be always applicable to others.

Vietnam has no system guidelines on the good corporate governance practices although some of them have been stated in the Companies Law and Decree 144 on listed companies and other relevant regulations. As for joint stock corporations, good corporate government practices should be clearly stipulated in articles of incorporation.

It is very important to make companies understand that pursuing and applying good corporate governance practices will bring about virtual benefits, not burdens, and although companies could face some difficulties at the beginning; so that the good corporate governance model could be broadly accepted in Vietnam. Benefits for companies applying these practices could be as follows:

- The company value will be higher, which could encourage banks to be ready to grant better credits and lower interest rate and investors to buy company's shares with higher market price. A recent survey conducted by MacKinsey & Company has showed that companies implementing good corporate governance practices would typically generate a 10-12% increase in their value. Another McKinsey & Company study of the 100 biggest listed companies in Thailand found that the Thai companies with the best overall corporate governance had average market valuations which were 45% higher than the average for the companies in the lower groups in terms of corporate governance standards.

- By financing the company, banks and/or institutional investors shall apply their management experience in operating business activities so that company performance will be more improved and effective.

- Higher investment efficiency: Return on capital employed will be higher thanks to better ability to make good decisions and application of effective control methods. A survey done by Credit Lyonnais Security Asia has found that the average ROCE for the 100 largest emerging markets was 23.5% in 2000. However, the companies in the top quartile of corporate governance standards had an ROCE of 33.8% while ones in the bottom half of corporate governance standards had an ROCE of 16%.

- Mitigation of risks: A good corporate governance model will help the board of directors improve its ability to recognize various risks in business and therefore can better control these risks. Managers and shareholders shall realize that they will be less suffered from internal fraud, loss, thefts or illegal transaction since transparency has been enhanced by clearly defining individual responsibilities.

As analyzed above, once the company has applied and maintained good corporate governance practices, it shall attract more funds from major banks and/or institutional investors to serve its investment and growth targets, and get itself listed in the stock exchange since corporate governance standards are very much close to and matched with listing requirements.■