

ESTABLISHING MARKET FACTORS IN THE RELATION BETWEEN PARENT AND SUBSIDIARY COMPANIES

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To have an overview on the policy to develop the model of parent and subsidiary companies, we should first see reasons for this policy and the position on the model taken by the policy makers, especially that of the Ministry of Planning and Investment. Then we could present remarks and solutions to the problem.

In its report to the PM, the MPI gives the following summing-up:

"Eight years after the development of Corporations 90 and 91, the corporations have established the control over many key industries but they failed to reach their full potentials as expected. The model of corporations contains the following shortcomings:

- The formation of corporations is based on administrative relations and a loose connection between companies instead of mutual investment and control.

- Relations in terms of capital, assets and technology between corporations and its member companies isn't close enough. The main shortcoming is the lack of a document that distinguishes rights, duties, assets and legal entity of the corporation and its members. The corporation failed to support the development of its members. Therefore, most corporations failed to become a united entity that could make the best use of all members as a whole.

- The corporations faced many organizational and management problems that hindered their development.

- Structure and position on the membership isn't

suitable to the changing reality. The corporation includes only state-owned companies and its membership kept reducing in the privatization process.

- Policies on corporations and its members relating to investment, payback, capital accumulation, amortization and reinvestment prevent them from developing into strong groups of companies."

The new policy takes a new view on the parent and subsidiary companies in which the parent company is formed and registered according to the Vietnamese law. It holds the whole registered capital of its subsidiary companies or more than half the share capital of other companies, thereby keeping the control over them. The control over the subsidiary company is the right to decide on main personnel, organization, marketing, and other important managerial decisions, or the right of veto for a shareholder.

The parent company has its own legal entity, assets, name, organizational machinery and head office in Vietnam. The parent company uses its assets and capital to invest in, buy shares from or enter joint ventures with, other companies.

Subsidiary company is a company of which more than half, or the whole, the share capital is owned by another company, thereby being under control of that company.

A parent company can have the following kinds of subsidiary companies: joint stock companies, limited companies with at least two members, joint

ventures with foreign partners, one-member limited companies, and state-owned companies under state-owned parent companies.

First of all, we want to say about the summing-up of shortcomings of the current model of corporations. Remarks presented in the summing-up is basically exact but it seems to us that related authorities fail to realize market factors in the relation between the corporation and its members. This implies that these authorities seem to fail to accept and point out basic factors that determine success in developing the relation between corporations and their members. This failure makes all efforts to change corporations and its members into parent and subsidiary companies useless.

Market factors in the relation between the parent and subsidiary companies are easy to see. They are related to the control over share capital and autonomy in the relations with one another and with other companies. These relations are free from administrative decisions or limitations without solid and proven grounds. Such limitations and administrative interventions make the model of parent and subsidiary companies end in failure. For example, related authorities still argue over the right by the subsidiary companies to invest in the parent company. There are two opinions about this right.

- Subsidiary companies are free to invest in other companies but they mustn't invest in the parent one

in order to prevent uncontrollable and "dummy" investments.

- It's wise to set no limitations on investment in the parent company by its subsidiaries, or at least they are allowed to invest a certain proportion of its legal capital in the parent company.

Experts from related authorities even point out the crisis suffered by South Korean chaebols because of inter-company investment while everybody knows that the causes of the chaebol crisis are the poor macroeconomic management by the Korean Government and effects of the 1997 Asian financial crisis.

The draft of the plan to change corporations and their members into parent and subsidiary companies contains many non-market factors and administrative interventions. The following are some examples:

- + The parent company has the right to decide on, amend or change contents of articles of incorporation of subsidiary companies.

- + The parent company has the right to make adjustment to the legal capital of the subsidiary company, decide on their privatization, transfer and percentage of the legal capital to be transferred to other organizations or individuals.

- + The parent company has the right to use the capital and other funds of the subsidiary companies for business and repay later.

We can easily see that these regulations are ambiguous and harmful to interests of subsidiary companies. Moreover, some of

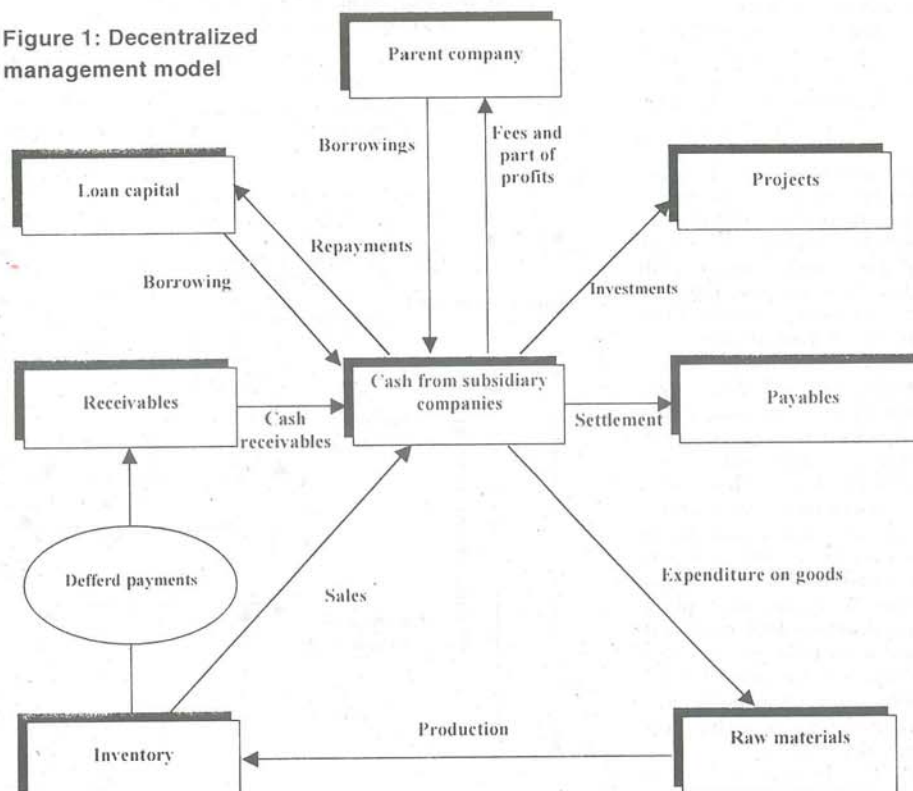
these regulations are never found in any countries (the right to use and repay later the capital of subsidiary companies for example). They are non-market factors that discourage all potential investors from putting their money in subsidiary companies. Maybe this mindset makes drafters of the plan want the parent company to hold at least 50% of the share capital of subsidiary companies, a target that is hard to achieve.

In the articles of incorporation of some HCMC corporations, there is even a regulation that allows the corporation to mobilize and regulate sources of foreign exchange controlled by its members to ensure the best use of the capital for the performance of the whole corporation. This regulation, in fact, has deprived its members of opportunities to integrate into the world market. The foreign exchange balance of company members could be upset whenever the parent company exercises this right. This situation could lead to exchange risk and reduce the ability to repay foreign debts by company members.

In our opinion, the Government should order the plan drafters to deviate from the old thinking way and establish market factors in the relation between parent and subsidiary companies instead of imposing the centrally-controlled mechanism on the relations. This must be considered as the basic principle for the plan to develop the model.

The capital ratio and regulations about mobilization of capital by issuing stocks and shares or borrowing from banks must be considered as the most important bases for the formation of the model of parent-subsidiary companies. This means that both parent and subsidiary companies could use any legal methods for mobilizing capital on the finance mar-

Figure 1: Decentralized management model



ket. The organization of the parent-subsidiary structure, therefore, must vary according to the capital ratio and methods of mobilizing capital.

In developed economies, all models and methods are possible if they help maximize the value of the group of companies. In the Vietnamese Coffee Corporation for example, let's imagine that any member could issue preferred stocks of which the dividend varies according to the market price of coffee without being prevented by the Corporation. The new plan to reorganize the public sector and state-owned companies had better make this business policy legal if it proves to be effective in increasing the value of the whole group because this practice isn't against the law.

Now we want to discuss goals of the MPI draft of the decree on development of the parent-subsidiary model to be submitted to the PM. The draft says,

"The goals of the plan to organize state-owned corporations and their company members into parent and subsidiary companies are to overcome shortcomings of the current model of corporations, to separate legal entity of the corporation and that of companies where the corporation invest in; to clarify rights, duties and responsibility of the corporation in relations with its subsidiaries, and create conditions for large-scale corporations develop into groups of companies. The plan aims at building the legal infrastructure for the pilot scheme to change some corporations and their members into parent and subsidiary companies before applying it on a larger scale as suggested by the Resolution 3 of the VCP Central Committee (9th term)."

Studying this paragraph carefully, we saw that the main goal of the draft decree was to overcome shortcomings of the current model of corpora-

tions. This means that the plan only deals with existing shortcomings without thinking of a long-term strategy although drafters hope corporations will gradually develop into groups of companies.

We think so because of the fact that the Government hasn't accepted the establishment of markets; especially capital and money markets, in relations between the parent and subsidiary companies. The official interpretation of the draft of Articles of Incorporation for HCMC-based corporations seems to affirm again this remark. In the best part of the draft, only rights and duties of the parent company are mentioned, sometimes unnecessarily (formation of amortization and contingency funds, distribution of profits and investment protection, etc.).

If market forces are allowed to regulate the relations, the draft needs only suggest general principles and leave managerial and

organizational problems to managers. These problems will be presented in articles of incorporation of each company, either parent or subsidiary one.

Studying the articles of incorporation of an HCMC-based corporation, we are really surprised to see that it is almost a copy of the draft decree. Will the decree become the articles of incorporation of the group of parent and subsidiary companies? Meanwhile, the draft has only a few lines to say about the role of subsidiary. It seems to us that the drafters are afraid of losing the socialist orientation when establishing market factors in the relations between parent and subsidiary companies. If in the first place the drafters feel reluctant and want to keep the lion's share for the parent company, then what is the difference between the new and old models?

In our opinion, when adopting the policy to organize state-owned companies into parent and subsidiary companies, the Government should establish firmly market factors in the relations between parent and subsidiary companies. These factors could be seen in the centralized management model (Figure 1) or the decentralized management one (Figure 2).

In the decentralized model, subsidiary companies enjoy full autonomy in their transactions, including financial ones, with the parent company and others, including the foreign ones. Subsidiary companies could mobilize capital from the parent or the finance market at will after weighing profits against risks. If the risk involved is low according to their estimate, they could get capital from the finance market, otherwise they could borrow from the parent. If the parent refuses to help, they could issue shares on the capital market.

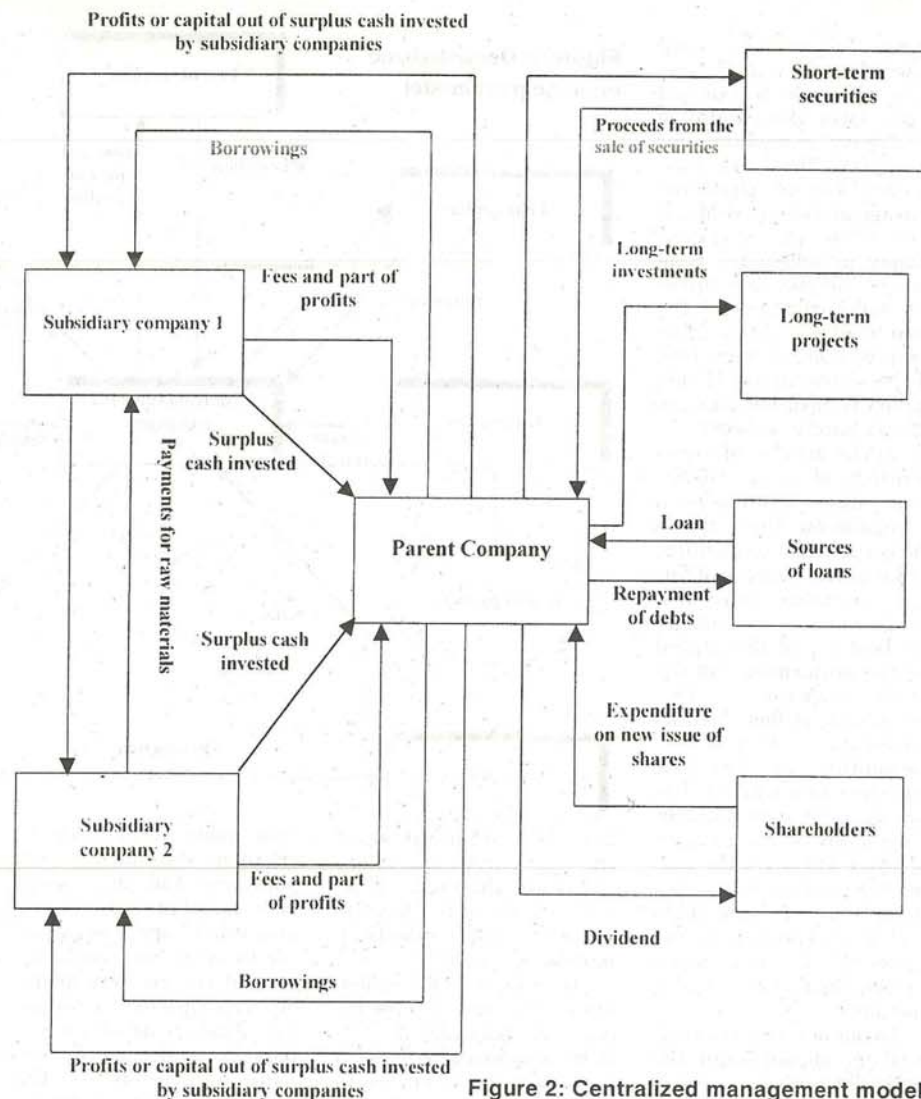


Figure 2: Centralized management model

In the centralized model, all sources of capital flow to the parent company that bears full responsibility for making the best use of them, either in short-term or long-term investments.

Of course, nothing limits the choice of companies. Their choice between those two models depends on current conditions and percentage of share capital they hold. Moreover, they could move from this model to the other with a view to maximizing the value of the group. To achieve this goal requires good managerial skills from personnel in both

parent and subsidiary companies. And as mentioned above, the only way to secure skilled managers is to establish market factors in all relations, including recruitment. The current mechanism in which directors and members of the Board are appointed by the governing ministries will never transform qualitatively the organization of the parent-subsidiary groups in the international integration process.

In short, the message we want to send to the Government in its effort to develop state-owned companies and corporations into parent and subsidiary

companies is that the Government had better order decree drafters to deviate from the old thinking way that tends to protect vested interests while acting supporters of the economic reform. To change our mind-set radically and establish market factors in the relations between parent and subsidiary companies is the only way to make the best use of limitless resources of each company of the group to change quickly corporations into strong groups of companies in the integration process. ■