

PERSPECTIVE

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Vietnam's New Wave of SOE Equitization: Drivers and Implications

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EXECUTIVE SUMMARY

- The Vietnamese government has recently made significant new efforts to greatly accelerate the equitization (i.e. partial privatization) and divestment of its state-owned enterprises (SOEs).
- This new wave of equitization is driven by four main factors: the government's need to mobilize financial resources to deal with rising fiscal deficit and public debt; an increasing sense of urgency about SOE reforms following a string of SOE failures; obligations under free trade agreements; and improved conditions of Vietnam's stock exchanges.
- The government will face difficulties in valuating SOEs and finding financially capable investors for these firms, given their relatively larger size.
- If the plan is successful, it may help improve Vietnam's long-term economic performance, attract a greater inflow of foreign investment, and contribute to Vietnam achieving emerging market status.

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INTRODUCTION

Over the past 30 years, the restructuring of state-owned enterprises (SOEs) has been a key component of Vietnam's economic reforms under *Doi Moi*. Nevertheless, it remains largely a work in progress. Following the collapse of such major SOEs as Vinashin and Vinalines which had devastating impact on the economy, SOE reform has since 2011 resurfaced as an urgent task for the country.

After the Communist Party of Vietnam's (CPV) 12th National Congress in January 2016 and the appointment of a new government led by Prime Minister Nguyen Xuan Phuc three months later, significant efforts have been made to accelerate the SOE reform. To guide this process, the Fifth Plenum of the CPV Central Committee in May 2017 passed a resolution on the restructuring of SOEs. Among the key measures adopted was the acceleration of the equitization of wholly state-owned enterprises and the divestment of those that have already been equitized but in which the state still holds a majority stake.

This Perspective article reviews Vietnam's SOE reform over the past 30 years before focussing on its recent efforts to accelerate the equitization and divestment of SOEs as well as the main drivers behind this process. Finally, the article discusses the implications of the process for Vietnam's economy.

EQUITIZATION: PRIVATIZATION WITH VIETNAMESE CHARACTERISTICS

In the 1980s, the Vietnamese economy was dominated by SOEs that enjoyed enormous privileges but that were largely inefficient. After the official introduction of the non-state¹ and foreign-invested sectors under *Doi Moi*, the Vietnamese government gradually adopted legal and policy reforms to create a more equal playing field for all economic players. It also began to restructure SOEs to make them more efficient and competitive. Apart from reorganizing SOEs and incentivizing them to operate on market rules, reforming the ownership structure of these enterprises was also an important task for the government. Indeed, without addressing the ownership issue, the motivation for these SOEs to become transparent, productive and competitive would be significantly constrained.

Against this backdrop, the Vietnamese government embarked on a plan in the early 1990s to equitize its SOEs, with the first SOE to complete the process in 1992. But the policy proved controversial and somewhat ideologically-charged. For example, in all the official documents, the process is referred to as *cổ phần hóa* (equitization) rather than *tư nhân hóa* (privatization). From the CPV's perspective, "equitization" is a more precise term as the state normally retains a large stake in most of the equitized SOEs, and only a limited amount of their shares are sold to private investors. Moreover, the term "equitization" carries a less negative ideological overtone. As the CPV still considers the state-owned sector the backbone of the "socialist-oriented market economy" that it strives for, the term "privatization" implies a deviation from its goal. Nevertheless, "equitization" and "privatization" are not clearly different in practical terms. Many non-essential SOEs have been wholly privatized, and the Vietnamese government has also reduced or completely

¹ The non-state sector includes collective, private and household businesses.

divested its stakes in many equitized SOEs, effectively turning these firms into private entities.

As shown in Table 1, 4,484 Vietnamese SOEs were equitized between 1992 and 2015, bringing the number of Vietnamese wholly-state-owned enterprises from around 12,000 in 1991 down to 652 by 2015 (Government of Vietnam, 2016, p. 4).²

Table 1 - Number of Equitized SOEs (1992 - 2015)

Phase	Legal Bases	Number of Equitized SOEs
Pilot phase (1992 to mid-1996)	Decision 202-CT	5
Extended pilot phase (mid-1996 to mid-1998)	Decreases 28 (1996) and 25 (1997)	25
Accelerated phase (mid-1998 to 2011)	Decreases 44 (1998), 64 (2002), 187 (2004), 109 (2007)	3,946
Economic restructuring phase (2011-2015)	Decision 929; Decreases 59 (2011); 189 (2013)	508
Total:		4,484

Source: Author's own compilation based on statistics from Ministry of Finance as cited in Cuong (2015) and Government of Vietnam (2016, p. 2).

The process can be divided into four major phases. The first two phases from 1992 to 1998 saw only 30 SOEs equitized, reflecting the government's cautious approach towards the issue. Moreover, the lack of stock exchanges, the first of which was not set up until 2000, also discouraged SOEs from being equitized. However, the number of equitized SOEs jumped in the 2000s, with the years between 2003 and 2006 being the most active period. During these 4 years, 2,649 SOEs were equitized (Cuong, 2015), accounting for almost 60 per cent of all equitized SOEs over the past 25 years. The surge in this period also coincided with Vietnam's preparation for WTO accession in early 2007 and was assisted by its growing stock exchanges. Since 2011, however, the pace has slowed down, with only 508 SOEs going into equitization between 2011 and 2015 (Government of Vietnam, 2016, p. 2).

A few reasons accounted for the slower pace of equitization during this period. First, after the 2007-2008 global financial crisis, the poor performance of Vietnamese stock exchanges discouraged SOEs from doing Initial Public Offerings (IPOs). Second, most of the remaining SOEs planned for equitization during this period were large ones, which prolonged their preparation for equitization. Moreover, it was also more difficult for them

² Vietnamese SOEs include three types: (1) Enterprises with entire capital owned by the state and controlled by central or local governmental agencies; (2) Limited companies managed by central or local governments; (3) Joint stock companies with domestic capital, of which the government holds more than 50% of charter capital. By the end of 2014, Vietnam had 3,048 SOEs of the three types (GSO, 2016, p. 261).

to find strategic partners given their large size as well as the adverse economic conditions during this period. Third, certain ministries and SOEs themselves were slow and not active enough in meeting equitization targets set by the government. Finally, the government's retention of majority stakes in most equitized SOEs and many equitized SOEs' failure to promptly get their shares listed on stock exchanges, caused investors, especially foreign ones, to lose confidence in the government's equitization programme (Government of Vietnam, 2016, p. 7).

VIETNAM'S NEW WAVE OF EQUITIZATION

Since the CPV's 12th National Congress in January 2016 and the introduction of a new government led by Prime Minister Nguyen Xuan Phuc three months later, there have been signs that Vietnam is accelerating the equitization and divestment of SOEs.

In February 2017, the government promulgated a directive requesting the Ministry of Finance to enact regulations and procedures to further facilitate the equitization and divestment of SOEs in accordance with international standards. Meanwhile, the Ministry of Planning and Investment was tasked with the establishment of a specialized body to replace ministries in overseeing the state's capital in SOEs, including equitized ones. The directive also holds government officials and SOE managers accountable for delays in SOE equitization. In May, the government approved a blueprint for SOE restructuring in the 2016-2020 period, under which the government aims to equitize 137 more SOEs by 2020, most of which are large ones. It also stresses the plan to undertake divestments worth at least VND250 trillion (US\$11 billion) from equitized SOEs during this period. In the same month, the Fifth Plenum of the CPV Central Committee passed a resolution on SOE restructuring, stressing again the task of accelerating the equitization and divestment of SOEs. In particular, the resolution set the goal of having most SOEs equitized by 2030.

As a result of these measures, in 2016 and the first 3 months of 2017, the government approved the equitization proposals of 63 SOEs, most of which are large enterprises. More than 10 major SOEs, including Vietnam Engine and Agricultural Machinery Corporation, Vissan, Resconha, Vinapharm, Vinafor, and FiCO, did their IPO in 2016. More major SOEs are earmarked for IPO in 2017 and subsequent years. These include big names in various industries, such as Agribank, Vinacomin, Vietnam Rubber Group (VRG), Vinafood 2, PV Power, PV Oil, Binh Son Refining and Petrochemical Company (BSR), Mobifone, Vietnam Posts and Telecommunications Group (VNPT), Vinataba, Vinachem, Vinacafe, VTV Cab, Vietnam Multimedia Corporation (VTC), Saigon Jewelry Company (SJC), Saigon Trading Group (Satra), and Saigon Tourist.

At the same time, as noted above, the government considers the divestment of equitized SOEs as no less important a task than the equitization of SOEs. By 2017, although 96.5 per cent of SOEs have been equitized, only 8 per cent of their stocks have been sold to private investors (*CafeF*, 2017). As such, there has been more symbolism than substance in Vietnam's equitization of SOEs over the past two decades. The limited amount of state capital sold to investors has prevented the government from achieving the core goal of equitization, that is to relocate state resources to more efficient sectors. As such, the

government's decision to accelerate the divestment of SOEs can be seen as the second, yet more important, phase of the SOE equitization programme.

To facilitate the divestment process, the government has ordered equitized SOEs, as well as those to be equitized, to have their shares listed on stock exchanges as soon as possible. Within a few months, a string of high-profile companies, some of which did their IPOs almost a decade ago, completed their listing process. These include some big names such as Vietnam Airlines, Airport Corporation of Vietnam, Sabeco, Habeco, and Petrolimex.

The government has also requested the divestment of SOEs to take place promptly and in a transparent manner. From 2011 to 2015, for example, the State Capital Investment Corporation (SCIC), which manages state capital in SOEs, conducted divestments worth VND8,726 billion (\$440 million). But in 2016 and the first 3 months of 2017, the value of its divestments reached VND4,116 billion (\$190 million) and VND12,139 billion (\$550 million), respectively (Ministry of Finance, 2017, p. 3). In the coming years, the divestment value will likely further increase as the government starts to divest its stakes in bigger firms. For example, the government has instructed the Ministry of Industry and Trade (MOIT) to sell its entire stakes worth up to \$3 billion in the two leading breweries Sabeco and Habeco through public auctions. As noted above, the government's plan was to divest at least VND250 trillion (US\$11 billion) from equitized SOEs between 2016 and 2020, which is far larger than its total divestment over the past 20 years.

DRIVERS OF THE NEW WAVE OF EQUITIZATION

Four major factors account for the Vietnamese government's decision to accelerate the equitization and divestment of its SOEs.

First, Vietnam's expanding budget deficit and public debt³ have made it increasingly difficult for the government to find funding for its development projects. Therefore, financial resources in the form of SOE stakes have become a valuable source of funding that the government wants to tap to support its growth target. The government has openly acknowledged this by stating that the VND250 trillion it sought to mobilize from SOE divestments between 2016 and 2020 was to fund public investment projects. This factor is probably the game-changer that makes Vietnam's new phase of equitization more substantive than previous ones.

Second, following the collapse of major SOEs such as Vinashin and Vinalines in 2011, the inefficiency of SOEs has recently been cast into the spotlight again after 12 major capital projects developed by SOEs were found to cause substantial loss to state capital. The public outcry against these projects, which led to the investigation and prosecution of a number of SOE managers as well as the sacking of former PetroVietnam chairman Dinh La Thang from the Politburo in May 2017, has generated a sense of urgency regarding the equitization of SOEs to improve their efficiency and accountability. At the same time, as SOEs have long been a hotbed for corruption, equitizing and subjecting them to public scrutiny is essential for the government to fight corruption. The government's acceleration of SOE

³ For an analysis of Vietnam's growing fiscal deficit and public debt, see Hiep (2016).

equitization can therefore be seen as part of the CPV's ongoing anti-corruption drive led by General Secretary Nguyen Phu Trong.

Third, a number of high-quality free trade agreements (FTAs) such as the Trans-Pacific Partnership (TPP) and the Vietnam-EU FTA that Vietnam is pursuing provide for a level playing field among economic actors. Under the TPP, for example, Vietnam's SOEs will have to operate on market principles and in a transparent manner. They won't be able to discriminate against the enterprises, investments, goods, and services of other member states. Neither are they allowed to receive subsidies or non-commercial assistance from the government that may have adverse effects on other member states' businesses. As such, equitizing SOEs and reducing the government's stake in these enterprises become a measure to keep Vietnam compliant with its international obligations under these free trade agreements.

Finally, Vietnam's stock exchanges have recovered significantly in recent years. For example, by the end of June 2017, the VN-Index of the Ho Chi Minh City Stock Exchange (HOSE) has risen to above 770 from its nine-year low of 235.5 in February 2009. The upbeat conditions of the stock markets and the greater inflow of foreign capital have facilitated the equitization and divestment process as SOE managers are now less concerned about the possibility of capital loss due to adverse market conditions.

CHALLENGES AND IMPLICATIONS

Despite the government's determination, a number of challenges threaten to obstruct the process. Given the large size of SOEs to be equitized or divested, the valuation of these enterprises may take longer to complete. The government's request to have the process done in a transparent manner to prevent possible loss of state capital and assets will also cause government officials and SOE managers to be more cautious, which tends to slow down their decision-making. At the same time, it is difficult to find financially sound investors who are interested in these large SOEs. Apart from the large investment they need to commit, a concern for investors is that despite the government's divestments, the ownership room for private investors in many major and attractive SOEs remains rather restricted. These firms are still subject to the government's interventions and investors' ability to shape their business strategy and governance is still limited. Last but not least, the process may be delayed by technical or corruption problems. For example, the divestment of Habeco, which was initially planned to take place in 2016-2017, has been delayed due to a dispute between Habeco and Carlsberg, its strategic partner, over the latter's right of first refusal. Meanwhile, the long-awaited equitization of Mobifone has also been put on hold due to the government's investigation into a suspicious acquisition deal that seems to have been designed to siphon off money from the company ahead of its equitization.

Nevertheless, the government's determination to accelerate the process remains strong, especially given its urgent need to mobilize monetary resources from SOEs to finance its budget deficit. If implemented successfully, the government's plan will generate significant impact on the Vietnamese economy. First, a smaller but more efficient state-owned sector will further strengthen the foundations of Vietnam's market economy and improve its performance in the long run. Second, the equitization and divestment of large SOEs will

bring foreign investors new opportunities, thereby attracting more foreign investment and further deepening Vietnam's international economic integration. Finally, as the process ultimately results in the increased size and liquidity of the Vietnamese stock exchanges as well as the reduction of foreign ownership cap in listed enterprises, Vietnam will stand a better chance to be included in the MSCI Emerging Markets Index. This prospect, in turn, will help further expand Vietnam's financial markets and strengthen its long-term economic outlook.

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