

FROM CONTROL TO MARKET:

TIME FOR REAL SOE REFORM IN VIETNAM?

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Acknowledgements

The publication of this report was jointly sponsored by the Centre for Governance, Institutions and Organisations (CGIO) at the National University of Singapore Business School and the Chartered Institute of Management Accountants (CIMA). This report was prepared by Dr Markus Taussig, Mr Nguyen Chi Hieu and Ms Nguyen Thuy Linh. We would like to thank all our partners and colleagues who have provided their time, materials, insights, experience, and support to make this report possible. We are grateful for the valuable and critical feedback from Dr Nguyen Dinh Cung (CIEM), Professor Vu Minh Khuong (NUS Lee Kuan Yew School of Public Policy), and our CIMA partners. The administrative assistance of Ms Desiree Koh and Ms Jamilah Ramli (CGIO) are also greatly appreciated.

Disclaimer

All views and opinions expressed in this report do not necessarily reflect those of CGIO, NUS, and CIMA, but remain the sole responsibility of the authors.

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Foreword by CGIO

“From Control to Market: Time for Real SOE Reform in Vietnam?” is the second in a trilogy of reports that seeks to look at State-owned Enterprises in Asia and their roles in shaping the economies they are in. The first research study focused on Singapore’s Temasek Holdings and its contribution to the transformation of the country from developing to developed nation.

This report turns its attention to Vietnam. It is particularly timely because the gears of reform are gathering momentum in the country and the restructuring of its SOEs is an integral part of its structural reforms. The focus is on Vietnam’s SOEs and what improvements are needed in their management and privatisation programmes in order to boost the country’s economy in the run-up to the 2016 Party Congress.

This study has been made possible with the sponsorship and support of our valued partner, Chartered Institute of Management Accountants, with whom we also collaborated for the first report. I am deeply appreciative of the writers, Dr Markus D Taussig, Mr Nguyen Chi Hieu and Ms Nguyen Thuy Linh, who have dedicated themselves to bringing this project to fruition. Thanks also goes to the research team whose tireless work contributed to the completion of the project.

Professor Chang Sea Jin

Executive Director

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Foreword by CIMA

The Chartered Institute of Management Accountants is pleased to support the research on State-owned Enterprises conducted by the Centre for Governance, Institutions and Organisations; and NUS Business School, National University of Singapore.

We commend the research that has been completed on SOEs in Singapore and Vietnam and their roles in shaping the economies they are in. There is much that we can learn from SOEs. In the case of Temasek Holdings, a commercial investment company owned by the Singapore government, it has played a vital role in transforming Singapore from a developing to a developed country. Good corporate governance in Temasek Holdings, government-linked companies, and government-linked real estate investment trusts was instrumental in their success as economic contributors to Singapore. Indeed greater transparency and good corporate governance will, inevitably, increase the efficiency of SOEs.

We strongly believe that both the research concluded on SOEs in Vietnam and in Singapore will provide invaluable insights to other Southeast Asian countries seeking to reform their SOEs.

We wish CGIO the very best in their further research on SOEs in Asia.

Irene Teng
Regional Director, South East Asia and Australasia
CIMA

Acronyms and Abbreviations

AICPA	Association of International Certified Professional Accountants
ASEAN	Association of Southeast Asian Nations
BTA	Bilateral Trade Agreement
CEO	Chief Executive Officer
CGIO	Centre for Governance, Institution and Governance
CIEM	Central Institute for Economic Management
CIMA	Chartered Institute of Management Accountants
ECNA	The Economic Commission of the National Assembly
EVN	Vietnam Electricity
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GENCO	Power Generation Company
GSO	General Statistics Office of Vietnam
ICOR	Incremental Capital Output Ratio
IPO(s)	Initial Public Offering(s)
JSC	Joint-stock Company
MOF	Ministry of Finance
MPI	Ministry of Planning and Investment
ND-CP	Decree of the Government (Nghị Định - Chính Phủ)
NUS	National University of Singapore
OECD	Organisation for Economic Co-operation and Development
QD-TTg	Decision of the Prime Minister (Quyết Định - Thủ Tướng)
QH	National Assembly (Quốc Hội)
ROE	Return On Equity
SCIC	State Capital Investment Corporation
SOE(s)	State-owned Enterprise(s)
UNDP	The United Nations Development Programme
VCP	Vietnamese Communist Party
VDB	Vietnam Development Bank
VND	Vietnam Dong
WTO	World Trade Organisation

Executive Summary

This study provides an update on Vietnam's state sector and the Vietnamese government's ongoing effort to reform it. We begin by reviewing common justifications in Vietnam for state involvement as an equity owner. Among these justifications are claims that: (a) the state is a more socially responsible owner; (b) the state can use ownership as a means of overcoming common market failures; (c) the state can use ownership to substitute its weak regulatory capacity; and (d) the complexities of transferring state assets back into the private realm in a fair and transparent manner. While we recognise the power of each of these justifications, we argue that none outweigh the benefits to country and its people that would come from a truly rejuvenated reform process.

The study describes the current state of SOEs in Vietnam, noting that they remain a major component of the economy despite a steady decline in their contribution to GDP growth and total employment over the past decade. The continued impact of SOEs is particularly evident in their inefficient use of the country's scarce resources, as reflected in statistics such as the state sector's high incremental capital output ratio. Related is the state sector's high level of capital deepening, measured as fixed assets per employees, which is two times the national average.

The study concludes by reviewing current debates on SOEs and SOE reform with special focus on the need for streamlining corporate governance regulation, addressing transparency issues in the privatisation and IPO process, and the importance of attracting strategic investors with world class industry knowledge into the process. At the core, we see the central task of Vietnam's government to be one of transitioning from a path dependent attempt to influence the economy through direct involvement as a market player to a more comprehensive focus on its crucial role as the referee fairly and transparently setting the rules for all on the playing field. Moving towards this ambitious goal will not be easy but the wide-ranging benefits of doing so for the country, the people, and the government itself are surely worth the effort.

1. Introduction

The major theme in analysis and debate about transition from plan to market has always been the benefits of liberalisation centered on giving up on the comprehensive control over market forces that lies at the heart of Marxist-Leninism. SOEs were primary vehicles for carrying out this control, so their reform and privatisation has always been central to the transition process. From the start, it was understood that the state faced a core challenge of shifting from control through direct ownership of SOEs to maintaining order among market competitors through rule of law (Hoff & Stiglitz, 2002). Russia's "big bang", which involved massive transfers of state assets to a small elite, was rationalised as a means of quickly establishing political support for market institutions (Shleifer & Vishny, 1998). The "gradualism" approach adopted in China and Vietnam, in contrast, was argued by others to allow a more sustainable evolution of such support by giving reformers additional time to demonstrate the benefits of liberalisation (Dewatripont & Roland, 1992; McMillan & Naughton, 1992). In the end, while economic growth was far superior in the countries adopting the gradualist approach, both groups have struggled mightily to build market institutions.

In today's Vietnam, the core challenge faced by the state remains surprisingly similar to the one faced at the start of the transition process nearly three decades ago: how to move from control of the economy through direct ownership of SOEs to governance of non-state firms through reliable and transparent rules and institutions. Riedel and Tran (1997) once advocated a Taiwan-style process for Vietnam, whereby the state avoided the political challenges of SOE reform and focused instead on market institutions that applied equally to all. This alternative strategy allowed the Taiwanese private sector to flourish and marginalised the impact of SOEs on the overall economy. But powerful SOEs and the state agencies dependent on them (either as tools for control or sources of revenue) have impeded the building of transparent market institutions and the still highly inefficient state sector's consumption of scarce resources has crowded out private sector development. As a result, it is hard to see how Vietnam's positive growth story can continue under the status quo and SOE reform is, once again, front and center in the country's policy debates.

Understandably, investors view renewed promises of a reinvigorated reform process with a healthy dose of skepticism. The experience of the past two decades has involved many such promises and, even assuming real political commitment, the size of the challenge is not to be underestimated. The successes of the past two and half decades were primarily the result of aggressive dismantling of the central planning system and integration into the global economy. Along the way, the country neglected the mundane task of building a bureaucracy with capabilities to design and enforce transparent rules for governing the country's nascent markets. As a result, its uncertainty about how to proceed with SOE reform and what the results will be is not without merit.

This paper provides an update on Vietnam's state sector reform, with special attention to the challenges Vietnamese policymakers face in avoiding inherent risks and making the most of the government's assets. The following section of the paper (Section 2) takes seriously the fundamental question of why, in 2015, Vietnam is still home to a substantial state sector and still professes dedication to a "state-led economy". The section after that (Section 3) puts forward a picture of what Vietnam's state sector looks like today, with some consideration of the degree to which there has been change in recent years and the extent to which the government is promising intensified change moving forward. Section 4 then aims to put the stated reform agenda in a more realistic context by reviewing and discussing the main policy debates underway, as reflected in reports, editorials, and statements by the government, researchers, and the media. Finally, we conclude with a summary of where we believe things currently stand.

2. Why a State-led Economy?

In the post-Cold War era, the argument against having the state own a significant share of a country's economy is relatively straightforward. An overwhelming amount of evidence shows the individual-level financial incentives of private investors make them better decision-makers than state bureaucrats when it comes to most crucial business decisions, including responsiveness to customer needs, efficient allocation of factors of production, and identifying and testing of product and process innovations. Even the best known outliers largely help prove the rule: in Singapore, the government minimises the differences between state and private with the world's most highly incentivised bureaucracy, especially when it comes to the people involved in investing the country's substantial savings (CGIO & CIMA, 2014). Vietnam has shown little appetite for the politically sensitive move of introducing such incentives into its bureaucracy and inefficiencies associated with its state sector include poor resource allocation and substantial rent-seeking by the firms, their managers, and their employees.

So why do we still see substantial state ownership shares in Vietnam? Why has it been so hard for policymakers to follow through on promises to reform and privatise SOEs? The relative strength of Vietnam's state sector is even more remarkable when one notes that the country has consistently been a leading recipient of foreign investments and posted some of the most rapid growth rates in the world since 1990. Part of the story, of course, is that SOEs have benefitted from privileged access to capital, land, and foreign joint venture partners, as well as monopoly and oligopoly power in a variety of industries. Part of the rationale behind why this is true is that the VCP maintains a monopoly on political power and its leadership sees political risks to an unambiguous rejection of the core tenets of its founding ideology. But given the overall success of the country's economy and the fact that party leadership has shown the flexibility to change many other policies once considered fundamental, it is worthwhile to go further in trying to understand why SOE reform has been slow in Vietnam and what still impedes it today.

Surely a large part of the story of the Vietnamese state sector is an issue of path dependence, wherein incumbent SOEs house substantial resources and are represented in the government by interest groups that fear that any major structural change may leave them worse off. An obvious such group is SOE employees, given that their private sector counterparts enjoy significantly less protection and suffer from significantly more pressure than they do. Another appears to be SOE managers, many of whom will know that privatisation may lead to their replacement by more experienced private sector hands. These groups directly involved in the current operations of SOEs have substantial power to slow the privatisation process and are probably the most prominently cited obstacles to SOE reform. Government officials who directly oversee SOEs, at both national and subnational levels, also have reason to protect the status quo.

But there are at least four broader justifications for state ownership that hold some sway. Each relates, in part, to both a benefit of SOEs and a contrasting danger of relying on the private sector. The first is the one most commonly relied on by the incumbent interest groups described in the path dependence argument above: that the state is a more benevolent and socially responsible owner than any private sector investor. There may be some truth to this in some realms of social responsibility relating to the less stringent profitability expectations faced by SOE managers and how that may influence how they weigh tradeoffs in day-to-day operations. SOEs are also more likely to have a union representing their workers and less likely to be able to fly under the radar of regulators. But even in Vietnam's weak regulatory environment, SOEs have been caught engaged in plenty of socially irresponsible actions, so the support for this argument is mixed at best.

The second and probably most prominently recognised justification is the argument that SOEs have served as effective tools for addressing market inefficiencies. Particularly popular is the idea that they have served as a constructive tool for state control over macroeconomic challenges, especially during and after macroeconomic crises such as the one that hit most of the world in 2008. There is popular belief that heavy state involvement in China's economy helped minimise the effects of the latest global crisis and led to a relatively faster recovery (e.g. Zakaria, 2010). Parallel stories are told about the constructive role of SOEs in softening the effects of the crisis in Vietnam (Tran, 2013). It is also claimed that SOEs helped to minimise market failures such as "the price hike 'fever' of the real estate market, securities, and food" (Tran, 2014). In addition to questions about the accuracy of these claims of how SOEs influence the economy, the major issue with this line of argument is that it assumes a weak state unable to effectively regulate the market.

This weakness of the state, highlighted in the introduction of this paper, serves as the third justification for SOE ownership. Nearly 30 years after the formal introduction of the country's doi moi economic reform programme, Vietnam has made only limited progress in building even the most fundamental of market institutions such as those for contract enforcement, tax collection, or the protection of society from the inevitable negative externalities of business. The relationship between SOEs and taxes is clear in recent research that shows increased firm revenues and decreased tax payments among privatised firms in Vietnam (Tran & Dao, 2014). As a result, in addition to potentially corrupt reasons for obstruction already noted under the heading of path dependence, national and provincial governments also have legitimate reasons to be concerned that SOE privatisation will mean less revenues for providing crucial public services like policing and education. Such a financial crunch would then only exacerbate these same institutions' problems of weak capacities to regulate non-state businesses, which already results in frightening levels of industrial accidents and other disasters associated with unchecked bad behavior in the private sector.

There is, of course, substantial endogeneity to the relationship between justifications two and three. Not only is the need for SOEs as a tool for correcting market failures a function of the country's weak market institutions, but the continued strength of SOEs and their engagement in non-market activities are also likely to undermine the development of these crucial institutions.

The final justification relates back to the unfavorable Russian transition. While inequality and showy displays of wealth have naturally increased in recent years, a crucial element of Vietnam's doi moi growth experience has clearly been the substantial benefits borne at the bottom of the pyramid and real opportunities for upward mobility. This broad-based nature of Vietnam's growth has greatly increased the legitimacy of not only the Vietnamese government and the VCP, but also the economic reform process itself. A rapid increase in the accumulation of assets in the hands of a privileged elite would be sure to undermine these gains for all three beneficiaries. Naturally, there would also be reason for the VCP to be concerned about the potential of such centers of private wealth to either start shaping internal politics or to serve as an alternative to the party.

3. The Realities of SOEs Today

3.1 The State Sector

The state sector¹ accounted for about a third of the economy's GDP in 2013 and contributed nearly 30% to the country's GDP growth in 2005-2013. The sector accounted for about 10% of total employment in 2013, generating about 4% of new jobs during the period 2005-2013.²

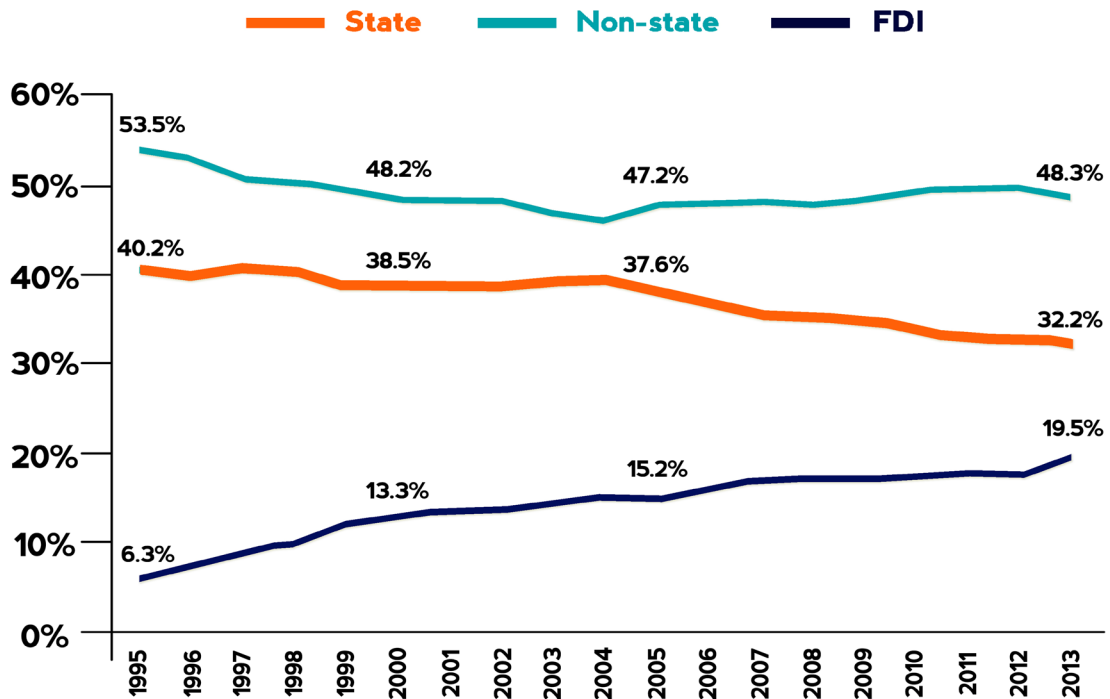
The state's share of the economy hovered around 40% until 2005, when it began a slow but steady decline (see Figure 1). A parallel but faster-falling decline has been seen in the state's share of employment (see Figure 2).³ The significance of 2005 is the launch of a new round of restructuring of SOEs and the introduction of a third Enterprise Law, as well as the start of a period of increased enthusiasm for Vietnam among foreign investors.

¹ The state sector comprises SOEs and state-related services such as public administration, defense, education and training, and health care. See Appendix 1 for the definitions of SOEs, Non-state enterprises, and FDI enterprises.

² See Appendix 2 for an overall picture of Vietnam's economy in 2000-2013.

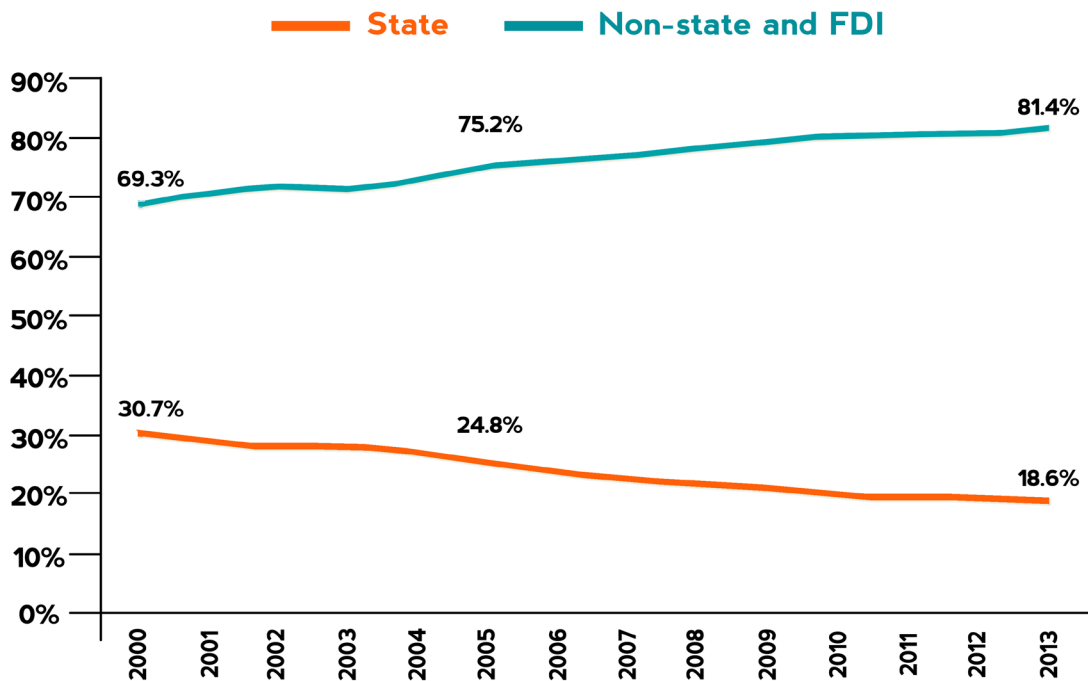
³ The state sector's share in agriculture employment is less than 1% and has always been very small.

Figure 1: GDP share by ownership



Source: GSO

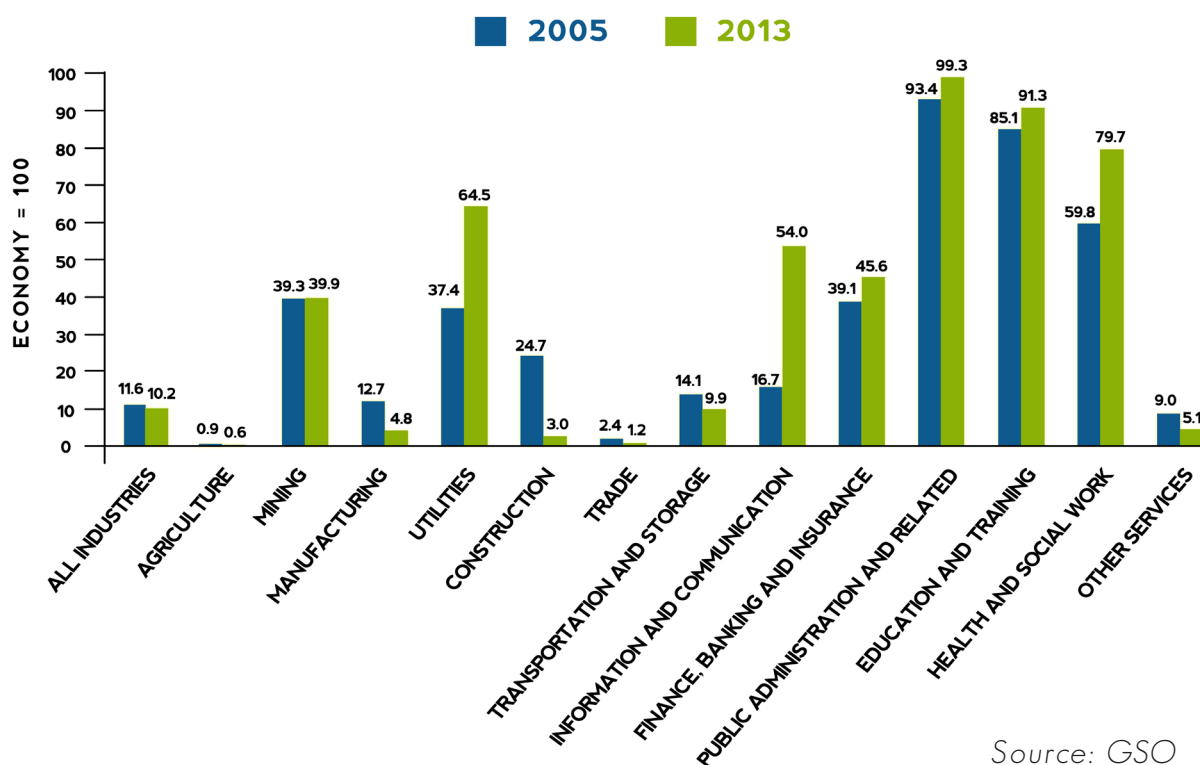
Figure 2: Non-agriculture employment share by ownership



Source: GSO

We can learn more by looking closer at the period of 2005-2013. In terms of employment, the state shifted more into a core set of industries. Figure 3 shows significant state sector employment share gains in utilities (from 37.4% in 2005 to 64.5% in 2013), information and communication (16.7% to 54%), and finance (39.1% to 45.6%). These are, of course, all industries the government sees as crucial infrastructure for proper functioning of the reforming economy. Meanwhile, Figure 3 also shows that the state sector's share of employment decreased dramatically in other areas: construction (from 24.7% in 2005 to 3% in 2013), manufacturing (12.7% to 4.8%), transport and storage (14.1% to 9.9%), and trade (2.4% to 1.2%).⁴ Overall, the state sector's share of industrial output⁵ declined substantially from nearly 25% in 2005 to about 16% in 2013. As Figure 4 shows, the largest gains in industrial output share are seen in the FDI sector over the years 2010 to 2013.

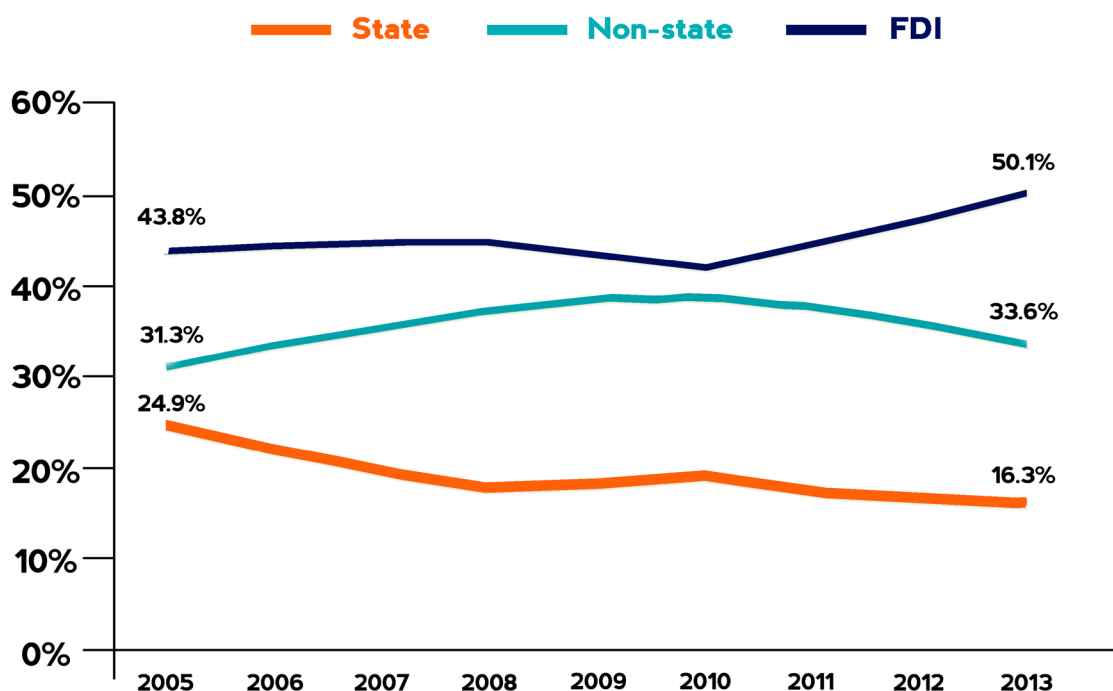
Figure 3: State sector's employment share by industry, 2013 vs 2005



⁴ It is also noted that employment of these industries decreased in absolute terms over 2005-2013.

⁵ The industrial output comprises output from mining, utilities, and manufacturing industries.

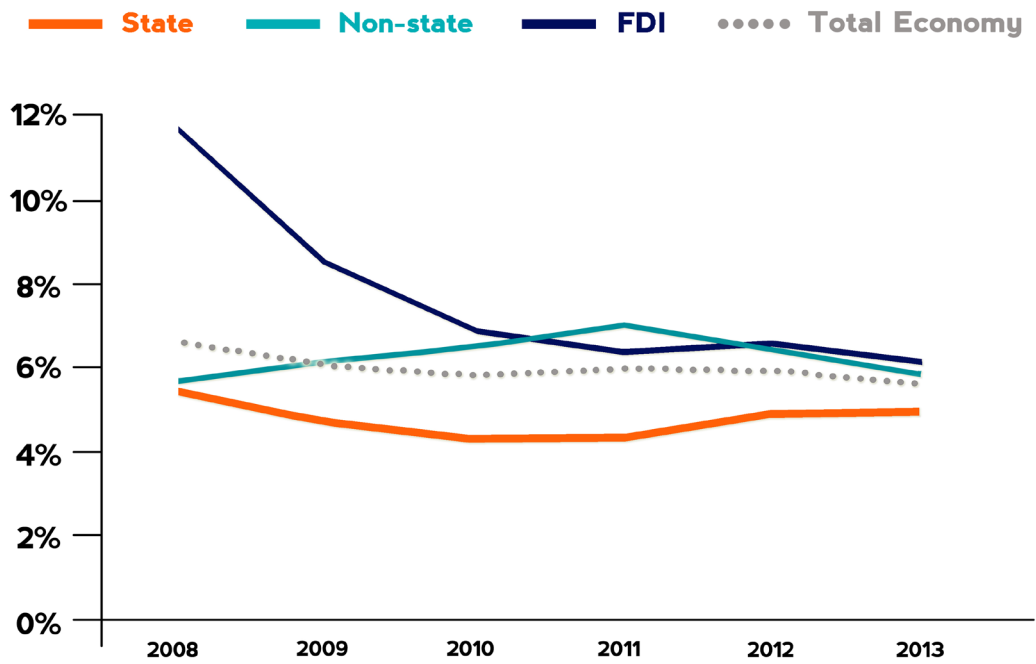
Figure 4: Industrial output share by sector, 2005-2013



Source: GSO

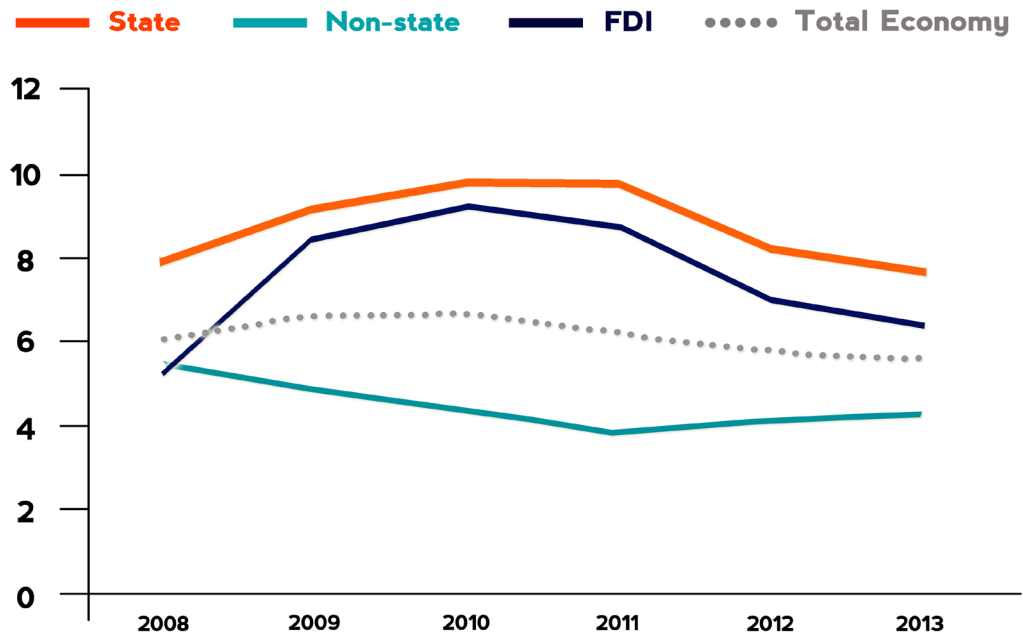
With regard to investment, the state sector has consistently claimed the highest share (about 40%) of annual total investments in Vietnam. However, the contribution of SOEs to GDP growth generally underperformed compared to those of other sectors (Figure 5). The inefficiency of SOEs is further reflected in the fact that the state sector has had the highest ICOR of all ownership forms (Figure 6). This is likely due to both of the following reasons. First, the overall incentive structure and the hiring and limited firing practices of SOEs are clearly not oriented towards maximising efficiency. Second, and perhaps less commonly appreciated, SOEs are active in much more capital-intensive areas of the economy and their preferential access to resources has led to far more investments into these industries than would occur if resource allocation was determined by markets. As such, Vietnam's limited action on SOE reform has had the dual consequence of trapping too many scarce resources both in the hands of less capable managers and in less productive economic activities.

Figure 5: GDP growth by ownership (3-year moving average)



Source: GSO

Figure 6: ICOR (3-year moving average)



Source: GSO

3.2 State-owned Enterprises

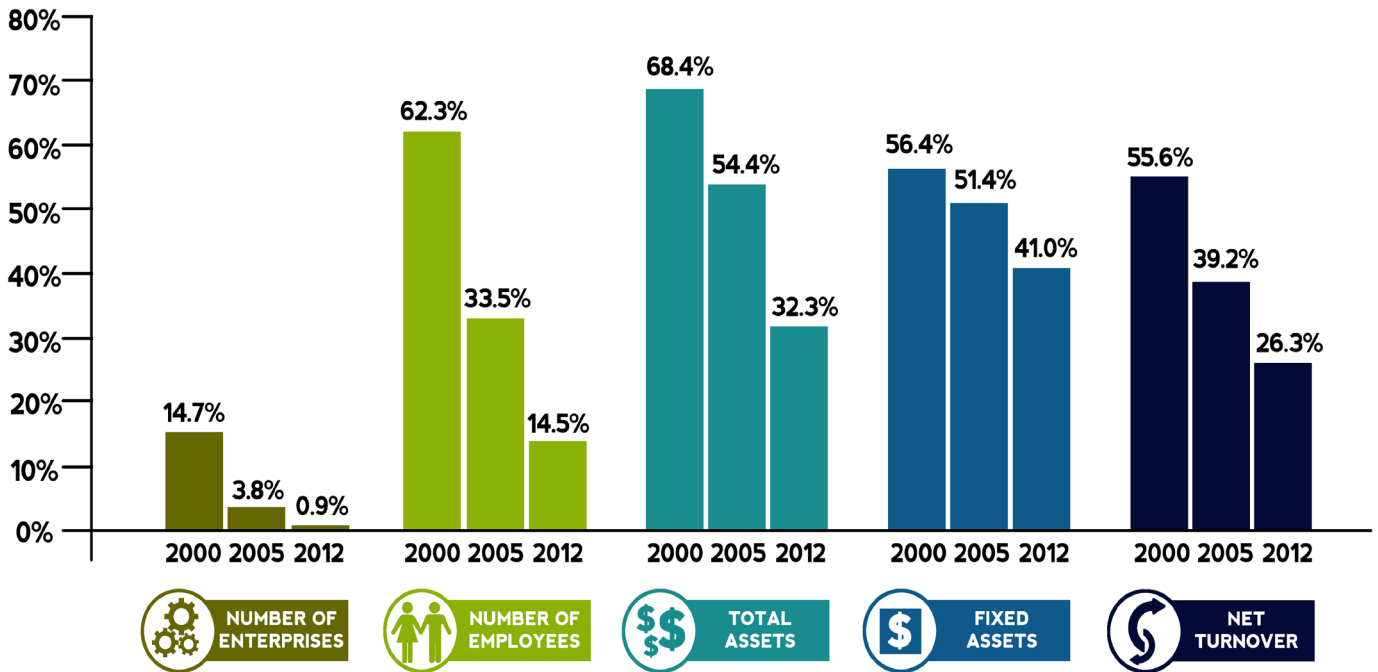
According to Decree 99/ND-CP (2012), SOEs are categorised into two types: (1) firms with state ownership of 100% charter capital in the form of a limited liability one-member company and (2) firms with state ownership above 50% of charter capital in the form of a joint-stock company and limited liability company with two or more members. This classification of SOEs is valid until July 2015.

Statistics on the GDP contribution of SOEs are harder to obtain than those of the state sector as a whole. Vu (2012) shows that SOEs contributed about 28% to the GDP over the period of 2006-2009, down from about 30% in 2001-2005. Combining this with the declining trend observed for the state sector as a whole, it is plausible to suggest that SOEs accounted for about a quarter of the GDP in 2010-2013. Statistics from the annual Enterprise Census show that SOEs employed about 2.1-2.3 million persons in 2000-2004 and then the number went down gradually to only 1.6 million in 2012. As such, SOEs' share in the economy's total employment contracted by nearly half during 2000-2012, from 5.6% in 2000 to 4.8% in 2005 to 3.1% in 2012.

Figure 7 compares SOEs to other legal forms of companies over 2000-2012.⁶ Strong growth in the domestic private and FDI sectors, together with ongoing restructuring efforts, has considerably reduced the relative role of SOEs. SOEs accounted for only 1%, 15%, and 26% in terms of the number of enterprises, employment, and turnover, respectively, in 2012 compared to much higher levels in 2000. The shares of total assets and fixed assets also dropped sharply during this period, though they were still sizable. SOEs were characterised by high levels of capital deepening, measured as fixed assets per employee. In fact, this level was over two times higher than the economy's average during 2010-2012.

⁶ See Appendix 3 for more details on these indicators.

Figure 7: Share of SOEs among all acting enterprises



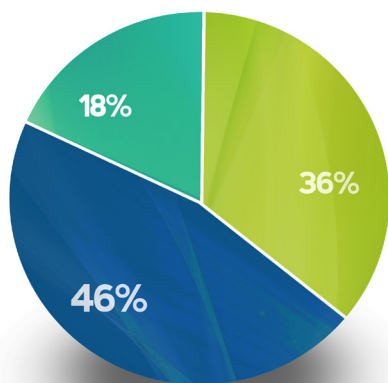
Source: Enterprise Surveys, GSO

Overall, the number of 100% state capital SOEs has dropped dramatically from more than 12,000 in 1990 to 5,600 in 2000 and further down to just more than 1,350 in 2010. By the end of 2013, this number stood at 949 and the plan for the end of 2014 hoped for fewer than 800 firms.

It is worth noting how substantial the state's share remains in partially privatised SOEs. Figure 8, based on data from Vu (2012), provides striking evidence. The state maintained a dominant share⁷ in more than a third (36%) of the SOEs at least partially privatised over the 2001-2011 period. The state's share remained, on average, about 57% across all of these firms, while outsiders accounted for only 29%.

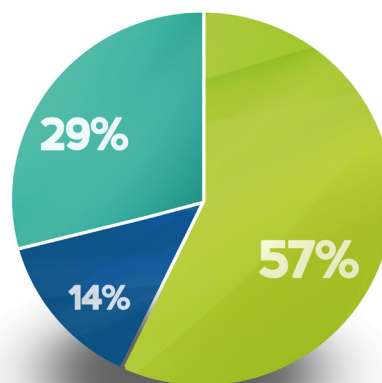
Figure 8: Remaining state control over fully and partially privatised SOEs

A) LEVEL OF STATE OWNERSHIP



- **DOMINANT**
- **NON-DOMINANT**
- **NO OWNERSHIP**

B) OWNERSHIP STRUCTURE



- **STATE**
- **WORKERS**
- **OUTSIDERS**

Source: Vu (2012)

⁷ Among 3,388 equitised SOEs over the period of 2001-2011, the level of state ownership was dominant in 1,217 firms (36%), non-dominant in 1,558 firms (46%), and there was no state ownership in the rest of the 613 firms (18%).

3.3 The Present Reform Agenda

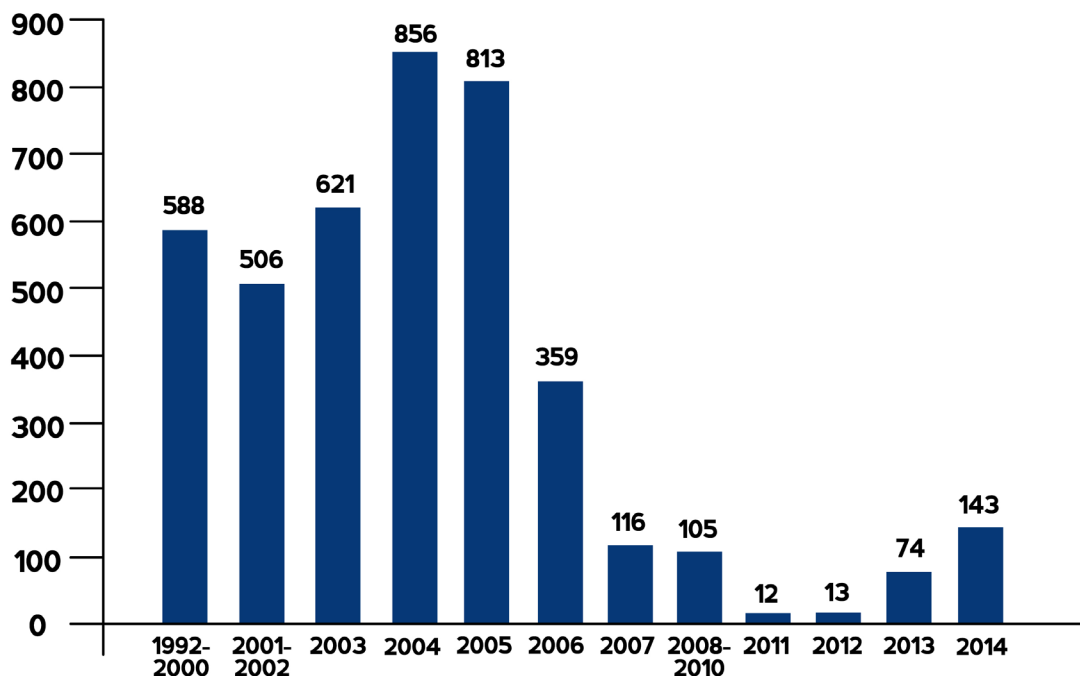
Recent government statements and initiatives have raised hopes that Vietnam has entered an important new phase of reforms focused on getting SOEs operating in line with market principles. The most notable pieces of legislation have been the revised Enterprise Law (Law No. 68/2014/QH13) and the Law on Investment and Management of State Capital Enterprises (Law No. 69/2014/QH13). The updated Enterprise Law, which will come into effect from July 2015, redefines SOEs to only include enterprises that are wholly owned by the state, instead of the current 51% rule.

Decree 71/ND-CP (2013) also aimed to provide solutions for SOEs struggling to meet requirements to divest out of their non-core areas. Specifically, it facilitates the sale of such non-core components to the SCIC (see Box 1). This means, of course, that these assets are actually still in state hands, but it is hoped that the SCIC will be better equipped to take action in the future. Other new legislative measures on SOE reform include Decree 61/ND-CP (2013), which provides regulations for monitoring and evaluating SOEs' financial performance and public disclosure, and Decree 206/ND-CP (2013), which includes guidelines for debt management of fully state-held SOEs.

Parallel to these regulatory measures on SOE reform, actual privatisation has also seen an increase: following privatisation of 74 SOEs in 2013, which was three times more than the number in 2011-2012, it appears that 143 SOEs were privatised in 2014 (Figure 9). However, this was still far short of the needed pace for meeting the government's stated target of equitising 542 SOEs in the period 2014-2015, leaving 389 SOEs to be equitised in 2015.⁸

⁸ Source: <<http://vef.vn/2015-01-21-co-phan-hoa-doanh-nghiep-nha-nuoc-mot-nam-nhin-lai>>

Figure 9: Number of equitised SOEs with 100% state chartered capital



Source: MOF

The most important impediments remaining in the privatisation process now appear to relate to the country's biggest privatisation targets. While the number of firms associated with general corporations and state economic groups is significantly smaller than the total number of remaining SOEs at local and provincial levels, the scale of state resources tied up in these big groups and the impact of these firms on the rest of the economy make them far more important in evaluating the reform process. As a result, pretty much all attention is now on whether and how the government will follow through on plans to move forward in 2015 or 2016 with initial public offerings of equity in high profile firms like MobiFone, the parent company of Vinacomin, and the three electricity distributors under EVN (Genco 1, 2, and 3). What happens with these plans during the remaining months of this year will go a long way to determining the nature of investor sentiment about Vietnam's investment environment.

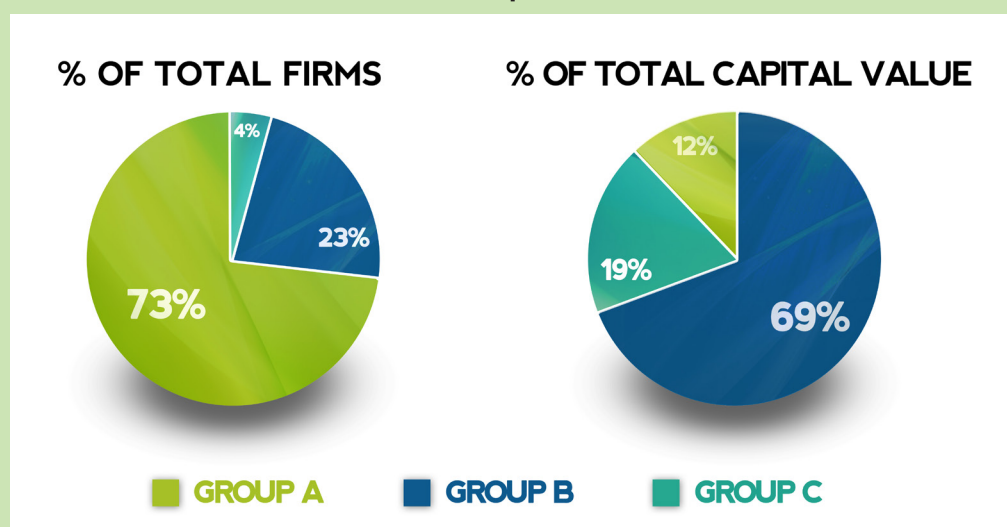
Box 1: State Capital Investment Corporation (SCIC)

The SCIC was formed through Prime Minister Decision 151/QĐ-TTg in 2005 with an initial charter capital of VND 5 trillion. The SCIC's mandate is to oversee ownership shares in SOEs assigned to it by the government, accelerate the restructuring of these SOEs, professionalise their management, and mobilise revenues for the state through the issuance of shares and other financial instruments. A recent example of how the government is using the SCIC is Decision 2344/QĐ-TTg in December 2013 from the Prime Minister's office, which lays out lists of SOEs to be assigned to the SCIC with specific instructions to maintain under 100% state capital investment, partially privatised through public offerings of equity shares or fully privatised.

According to Decree 99/ND-CP (2012), the SCIC must provide transparent reports about its performance and activities to the MOF and the Prime Minister. However, there is currently no requirement for it (or any other state-owned general corporations) to provide financial statements or an annual business report to the public. Nevertheless, it is clear that, as of June 2014, the SCIC's charter capital had grown to VND 65 trillion.

According to the mid-term report of June 2014, the SCIC is also managing equity stakes in 335 firms.⁹ The SCIC classifies these firms into three groups: A, B, and C. Group A includes firms believed to be operating effectively in key industries according to the SCIC's long-term investment strategy. Group B consists of mid-size companies with chartered capital or equity of VND 10 billion or more and ROE rates of 10% or more. Group C covers remaining firms that do not meet the criteria for Groups A or B. According to a summary of the first half of 2014 found on the SCIC's website, Group A accounts for only 14 (4%) of the 335 firms, but 69% of the state capital value of the SCIC's holdings. In contrast, Group C accounts for 73.1% of the number of firms in the SCIC's portfolio, but only 12% of the state capital value.

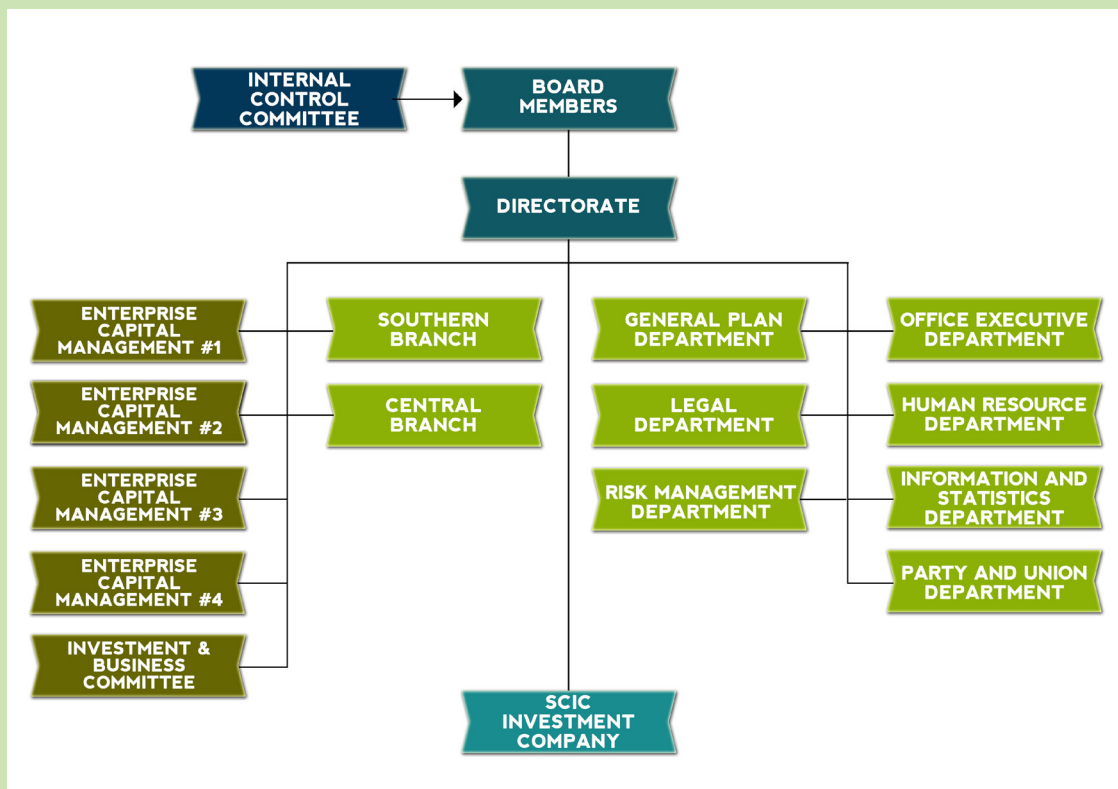
Chart 1: SCIC's domestic investment portfolio



Source: SCIC

⁹ The SCIC's portfolio statistics as of 30 June 2014 <http://www.scic.vn/index.php?option=com_content&view=article&id=140:scic-t-ch-c-so-k-t-6-thang-d-u-nam-2014&catid=27&Itemid=469>

Chart 2: SCIC's organisation structure



Source: SCIC

In terms of its management structure, the SCIC has both a corporate management and a separate board of directors. The CEO and board chairman are separate and unrelated persons. The SCIC's website shows that the majority of board members are from the MOF and provincial People's Committees. There does not appear to be any board members from the non-state sector.

4. Current Debates on SOEs and SOE Reform

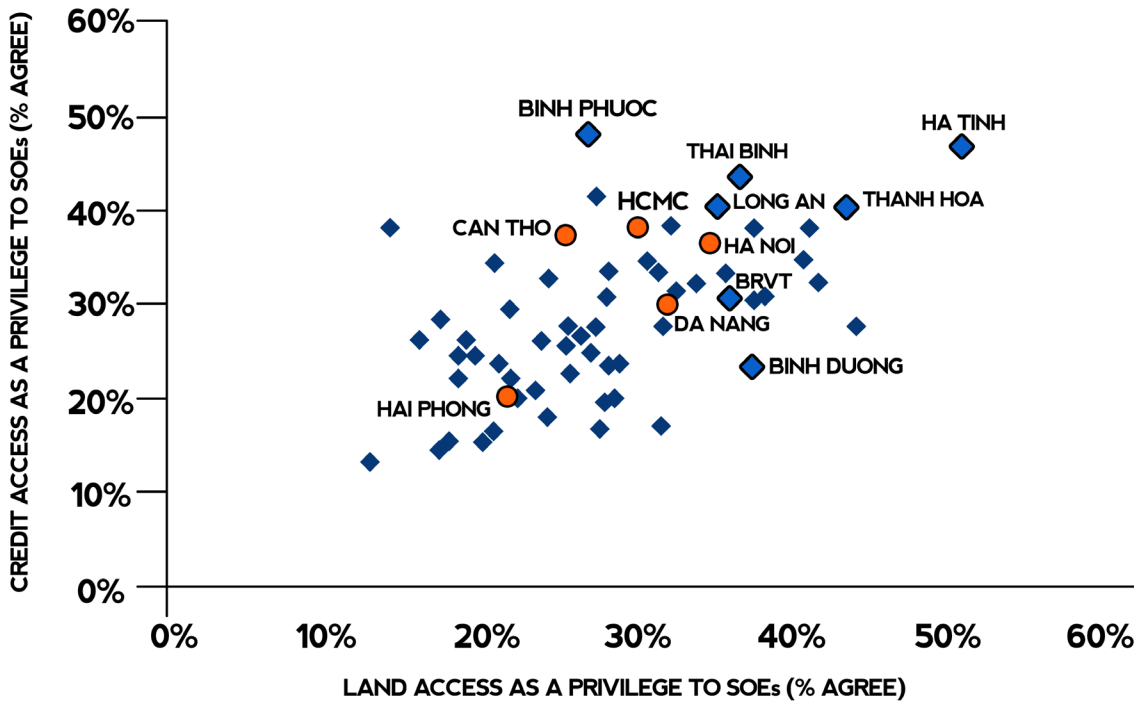
The main content of current public debate in the media and policy reports relating to the state sector generally falls into two main categories of reform, namely: (1) the broad government oversight and the internal management of firms in which the state is still a full or partial owner; and (2) the continuing process of privatising SOEs, especially the process of IPOs.

Vietnamese SOEs are still granted a variety of special privileges that give them a leg up on their non-state competition. First, the seemingly unconditional backing that SOEs enjoy from the government means that they and the resource markets that supply them discount the risk of bankruptcy even as losses accrue. Second, SOEs are able to turn a “state monopoly” into an “enterprise monopoly,” wherein they dominate the market and control prices with little evidence of special attention to hard-to-define issues of the greater public good. Third, SOEs can exploit Vietnam’s “ask and grant” norm, whereby extra state support is seemingly always forthcoming when SOEs complain of any difficulties. Finally, SOEs clearly enjoy preferential access to the country’s scarcest business resources, especially credit and land.

OECD (2013) points out that most of SOE financing has been from the SCIC, the VDB, and other state-owned commercial banks; while funding from more market-oriented sources like the stock market, strategic investors, or investment funds has been limited. This favorable pattern of financing is explained by the fact that lending to SOEs is considered to be guaranteed by the government and that, as a result, SOEs can borrow from banks on very easy terms with little disclosure or supervision by prudential authorities. Preferential support from the government has also come in the forms of supplementary capital, debt rescheduling, or even debt forgiveness in critical cases. In some special cases, the government has even paid SOE loan obligations to foreign commercial banks, which eventually creates substantial burdens on the state budget and clear moral hazards.

The effect of the special privileges to SOEs is two-fold. First, and most clearly, these privileges lead to crowding out private sector access to key resources and growth opportunities. Examining SOEs across provinces in Vietnam, Nguyen and Freeman (2009) shows that greater density of SOEs translates directly to greater difficulty for private companies in accessing bank loans or land. They also identify a negative correlation between SOE growth and private sector growth. This may help explain private entrepreneurs' perceptions towards SOEs, as reflected in the 2013 Provincial Competitiveness Index survey. As shown in Figure 10, 30-40% of private entrepreneurs in the country's major cities and provinces consider access to land and credit an area of special privilege for SOEs.

Figure 10: Private entrepreneurs' perception toward SOEs in 2013



Source: Malesky (2014)

The second, and perhaps less discussed, effect of the market advantages still given SOEs relates to the management and incentives within SOEs themselves. Easy access to resources naturally leads managers to feel less pressure with regard to the need to increase productivity and engage in difficult industrial upgrading activities, pointing them instead towards opportunistic and unrelated expansions of operational scope into non-core, low-hanging-fruit business activities. Such efforts frequently lead SOEs into activities wherein they lack competitive advantages and governance capabilities, and which are mostly speculative and rent-seeking in nature. This has included SOE ventures into banking, insurance, stock exchange activities, and real estate.

As a result, business activities of state corporations and economic groups in Vietnam are significantly more diversified than even other countries in the region famous for their highly diversified business groups.¹⁰

Corporate governance of firms in which the state still owns a stake is greatly complicated by the large number of government institutions involved and the limited transparency not only vis-à-vis the public, but also between these institutions. According to the Economic Commission of the National Assembly, Vietnam has 101 agencies in charge of the remaining fully state-owned firms. Many ministries maintain dual responsibilities for managing and regulating SOEs. As noted earlier, this creates a perverse set of incentives, wherein ministries hope to maintain control through ownership due to the greater direct access to revenues and the greater ease of regulating that results from this approach. In terms of the big picture, however, the main result for society is that no one government agency is fully responsible for cleaning up the mess of inefficient operations and non-performing loans.

As such, it is very important for Vietnam to substantially streamline its overall corporate governance approach to managing the remaining SOEs. There appears to be great potential for the SCIC to play a helpful role in making progress on this front. Another clear area for needed change is enhanced transparency for SOEs. Today, not even the MPI has full access to the financial reports of SOEs. Again, it would make great sense for the SCIC to be given power to help in this realm.

¹⁰ OECD (2013) shows that, on average, an economic group in Vietnam operates in 6.4 two-digit industries while comparable groups in Thailand, China, Indonesia, and Korea operate in only 3.5, 2.3, 2.1, and 1.7 two-digit industries, respectively. These state corporations and economic groups also have a larger number of subsidiaries - four times higher than in China and much higher compared to the Korean "chaebol" in their most prosperous period.

The World Bank recently released a focused report on the issue of transparency in Vietnam's state sector and hammered away at two very basic recommendations (Smith et al., 2014):

1. simplify and invigorate disclosure requirements on SOEs, including requirements for disclosure to the public;
2. punish non-compliance and reward compliance.

As is more than clear from extensive research work, including the recent report "Transformation and Transparency: Managing Local Government Performance", greater transparency will increase efficiency in these firms (CIMA & AICPA, 2014). It will also facilitate honest discussions about conditions under which it is appropriate for the state to maintain ownership in order to balance social and efficiency concerns. If, however, in contrast, the government continues to prove unable to enforce the most basic transparency requirements, it will become even more difficult to rationalise the status quo.

Another transparency issue is the market advantages that SOEs continue to enjoy relative to private companies. On paper, international agreements like those with the US (BTA) and the WTO have erased all the formal advantages that SOEs used to enjoy. But, in reality, SOEs clearly still enjoy a variety of significant advantages, ranging from preferred access to regulators to preferred access to credit and investment capital. This has been true even for SOEs with the most troubling balance sheets, with recent scandals like Vinashin and Vinalines being the natural consequence.

At the top of the list of discussion points relating to the second main category, the privatisation process, is the issue of strategic investors - specifically the failure, to date, to attract them in recent IPOs. The government has been very clear that it sees the value of strategic investors able to bring in industry-specific and internationally tested capabilities needed to turn around firms that have evolved under market protection and weak profit motives. Despite this, none of the latest IPOs, including Vietnam Airlines and Vietnam's main textile and garments SOE, Vinatex, resulted in the sale of any shares to a strategic investor. The government's decision to designate Vingroup, a local conglomerate best known for its real estate investments, and Vietnam Investment Development Group as strategic investors in the sale of Vinatex only served to drive home this point. Vinatex management had explicitly stated the need for strategic investors that could help the firm with accessing capital, specialised production technology, and distribution. There was also a clear desire for support to help the firm with brand development. Neither of the two local business groups that were ultimately named as strategic investors fits the bill, except perhaps in terms of assisting with capital.

Real strategic investors are clearly still uncomfortable with the current SOE reform context. In the context of the huge debt problems of many SOEs - the MOF has reported that accounts payable by SOEs at the end of 2013 stood at VND 1,500 trillion - potential investors are surely wary about the already mentioned problems with transparency. They also worry about how much control they will really be able to exercise with minor shares and about the unclear future prospects of increasing those shares once they get their foot in the door. Broader reforms, such as a raising of the upper limit on foreign holdings in Vietnamese companies, will go a long way to addressing this concern.

Essentially, Vietnam's government suffers from a credibility gap on the SOE reform issue. As such, it would make great sense for Vietnam to shift emphasis away from announcements of big target numbers and towards more transparency on what lies behind those numbers and the general process of executing reforms. Investors would clearly also be enthusiastic about increased transparency regarding asset valuation and the rules for the various forms of privatisation. They would also be far happier to see more substantial privatisations. This means selling off as much as 40-50%, instead of just single digit percentages that give the appearance of simply meeting targets without a serious intention to affect real enterprise-level change.

5. Conclusion

Change is in the wind for Vietnam. The government says it is ready for change. The economy needs change. But observers know that this has been the case before and, in the past, Vietnam's government has too often done only just enough to overcome the most immediate challenges. But the real change in SOE policy demanded by investors will require a willingness by the state to more fully transition from a system of control through direct ownership to one of governing the market through transparent rules and institutions. This will not be easy and the government's trepidation is understandable. But if the government can follow through on its plans, Vietnam may suddenly become a far more relevant economic player in the region and the world.

SOEs should be made to fit within Vietnam's key policy objectives rather than have the country's policies be contorted to the needs of SOEs. A first step is explicitly establishing the conditions under which the state sees a net advantage for society to maintain state ownership. SOEs, for which there is no such clear rationale for state ownership, should then be privatised in as quick, orderly, and transparent a fashion as possible. The SCIC is well-suited to facilitate this process. For the remaining SOEs, there should then be little reason for the state not to be able to enforce clear reporting requirements and make results available for public oversight.

This means letting go of the idea that SOEs deserve special treatment because they serve as a government tool for social policy and management of the economy. It also means reducing the number of SOEs to just those that the government has transparently determined as having a clear and socially beneficial rationale for state ownership. Competition needs to be encouraged with the state creating and facilitating a fair playing field while transparency and corporate governance are enforced to ensure that Vietnamese companies, state-owned or otherwise, can better integrate with the global market.

Appendices

Appendix 1 - Definitions of SOEs, non-state enterprises, and FDI enterprises

SOEs include the following types: (i) enterprises with 100% state capital operating under the control of the central or local governmental agencies; (ii) limited companies under the management of central or local governments; and (iii) joint-stock companies with domestic capital, of which the government shares more than 50% charter capital.

Non-state enterprises are enterprises set up with domestic capital. The capital may be owned privately with one or individual groups, or the government when the capital from the government is equal or less than 50% of the registered capital. These are the following types of non-state enterprises: (i) cooperative name companies; (ii) private enterprises; (iii) private limited companies; (iv) joint-stock companies with 50% and less of charter capital shared by the government; and (v) joint-stock companies without capital from the state.

FDI enterprises are enterprises with capital directly invested by foreigners not separated by the percentage of capital shared. There are two types of FDI enterprises: enterprises with 100% of capital invested by foreigners, and joint venture enterprises between domestic investors and foreigners.

Appendix 2

A. A brief profile of Vietnam, 2013

Official name	Socialist Republic of Vietnam
Form of state	One-party rule
National government	The Vietnamese Communist Party and, in particular, its politburo controls all branches of powers
Land area	330,951 km ²
Population	89.7 million
GDP	US\$ 171.4 billion PPP\$ 474.8 billion
GDP per capita	US\$ 1,910 PPP\$ 5,293
Exports	US\$ 132.2 billion
Imports	US\$ 122.3 billion



B. GDP and employment shares, and growth by ownership sector, 2000-2013

	Share in economy			Period 2000-2005		Period 2005-2013	
	2000	2005	2013	Growth	Contribution to growth	Growth	Contribution to growth
GDP							
Economy	100%	100%	100%	7.5%	100%	6.1%	100%
State	38.5%	37.6%	32.2%	7.5%	37.5%	5.0%	28.8%
Non-state	48.2%	47.2%	48.3%	7.0%	43.9%	6.1%	47.7%
FDI	13.3%	15.2%	19.5%	9.9%	18.6%	8.3%	23.6%
Employment							
Economy	100%	100%	100%	2.9%	100%	2.5%	100%
State	11.8%	11.6%	10.2%	2.7%	10.4%	0.9%	3.8%
Non-state	87.3%	85.8%	86.4%	2.5%	74.3%	2.6%	88.9%
FDI	1.0%	2.6%	3.4%	25.4%	15.3%	6.1%	7.3%

Source: GSO, World Development Indicators

Appendix 3 - SOEs among all acting enterprises in Vietnam's economy

	Number of enterprises			Number of employees			Total assets			Fixed asset and long-term investment			Net turnover		
	(unit)			(thousand persons)			(thousand billion VND)			(thousand billion VND)			(thousand billion VND)		
	2000	2005	2012	2000	2005	2012	2000	2005	2012	2000	2005	2012	2000	2005	2012
Total	39,051	106,616	346,777	3,354.7	6,077.3	11,084.9	1,092.0	2,655.1	15,189.8	407.4	946.9	6,097.1	800.1	2,140.6	11,167.8
State-owned enterprises	5,759	4,086	3,239	2,088.5	2,037.7	1,606.4	746.5	1,444.9	4,908.4	229.9	486.6	2,496.9	444.7	838.4	2,941.3
<i>Central</i>	2,067	1,825	1,792	1,301.2	1,432.5	1,191.5	647.4	1,260.9	4,464.1	185.5	402.7	2,275.5	316.9	663.4	2,482.8
<i>Local</i>	3,692	2,261	1,447	787.3	605.2	414.9	99.1	184.1	444.3	44.4	83.9	221.3	127.8	175.0	458.5
Non-state enterprises	31,767	98,833	334,562	858.6	2,819.1	6,758.5	105.3	682.2	7,711.7	29.6	190.7	2,424.3	193.4	833.8	5,797.4
<i>Cooperative name</i>	4	37	312	0.1	0.5	2.5	0.01	0.1	1.1	0.01	0.01	0.4	0.02	0.1	0.7
<i>Private</i>	20,548	34,646	48,159	236.3	481.4	543.0	18.1	72.1	297.2	7.1	23.9	88.5	71.1	172.4	468.7
<i>Private Limited Co.</i>	10,458	52,505	211,069	516.8	1,594.8	3,439.2	51.8	315.3	2,652.6	16.2	99.6	837.8	105.9	442.9	2,751.7
<i>JSC with state's capital</i>	305	1,096	1,761	61.9	280.8	475.4	11.6	125.2	1,024.9	2.9	25.1	240.0	10.3	103.9	577.7
<i>JSC without state's capital</i>	452	10,549	73,261	43.6	461.6	2,298.4	23.7	169.6	3,735.9	3.3	42.0	1,257.7	6.2	114.7	1,998.6
FDI enterprises	1,525	3,697	8,976	407.6	1,220.6	2,720.0	240.2	528.0	2,569.7	147.9	269.7	1,175.9	162.0	468.4	2,429.1
<i>100% foreign capital</i>	854	2,852	7,523	286.0	1,028.5	2,476.4	89.0	306.7	1,927.6	44.9	141.3	812.4	59.4	237.2	1,877.4
<i>Joint venture</i>	671	845	1,453	121.6	192.2	243.6	151.2	221.2	642.1	103.0	128.4	363.5	102.6	231.2	551.7
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
State-owned enterprises	14.7%	3.8%	0.9%	62.3%	33.5%	14.5%	68.4%	54.4%	32.3%	56.4%	51.4%	41.0%	55.6%	39.2%	26.3%
<i>Central</i>	5.3%	1.7%	0.5%	38.8%	23.6%	10.7%	59.3%	47.5%	29.4%	45.5%	42.5%	37.3%	39.6%	31.0%	22.2%
<i>Local</i>	9.5%	2.1%	0.4%	23.5%	10.0%	3.7%	9.1%	6.9%	2.9%	10.9%	8.9%	3.6%	16.0%	8.2%	4.1%
Non-state enterprises	81.3%	92.7%	96.5%	25.6%	46.4%	61.0%	9.6%	25.7%	50.8%	7.3%	20.1%	39.8%	24.2%	39.0%	51.9%
<i>Cooperative name</i>	0.01%	0.03%	0.09%	0.00%	0.01%	0.02%	0.00%	0.00%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%	0.01%
<i>Private</i>	52.6%	32.5%	13.9%	7.0%	7.9%	4.9%	1.7%	2.7%	2.0%	1.7%	2.5%	1.5%	8.9%	8.1%	4.2%
<i>Private Limited Co.</i>	26.8%	49.2%	60.9%	15.4%	26.2%	31.0%	4.7%	11.9%	17.5%	4.0%	10.5%	13.7%	13.2%	20.7%	24.6%
<i>JSC with state's capital</i>	0.8%	1.0%	0.5%	1.8%	4.6%	4.3%	1.1%	4.7%	6.7%	0.7%	2.6%	3.9%	1.3%	4.9%	5.2%
<i>JSC without state's capital</i>	1.2%	9.9%	21.1%	1.3%	7.6%	20.7%	2.2%	6.4%	24.6%	0.8%	4.4%	20.6%	0.8%	5.4%	17.9%
FDI enterprises	3.9%	3.5%	2.6%	12.1%	20.1%	24.5%	22.0%	19.9%	16.9%	36.3%	28.5%	19.3%	20.2%	21.9%	21.8%
<i>100% foreign capital</i>	2.2%	2.7%	2.2%	8.5%	16.9%	22.3%	8.1%	11.6%	12.7%	11.0%	14.9%	13.3%	7.4%	11.1%	16.8%
<i>Joint venture</i>	1.7%	0.8%	0.4%	3.6%	3.2%	2.2%	13.8%	8.3%	4.2%	25.3%	13.6%	6.0%	12.8%	10.8%	4.9%

Source: Enterprise Surveys, GSO

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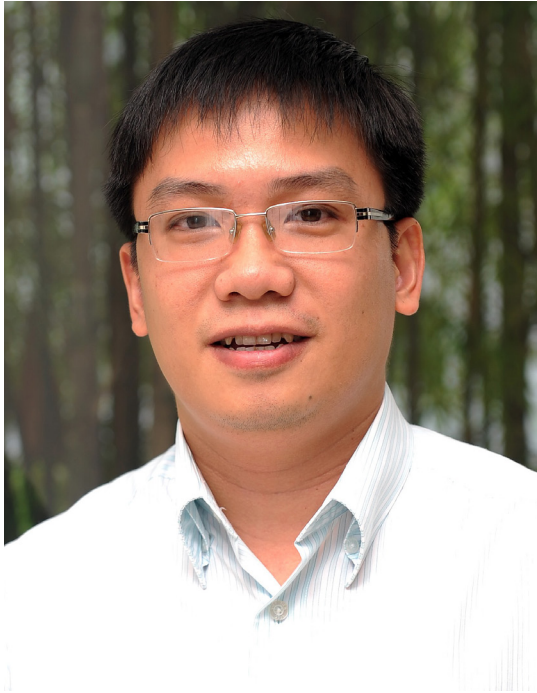


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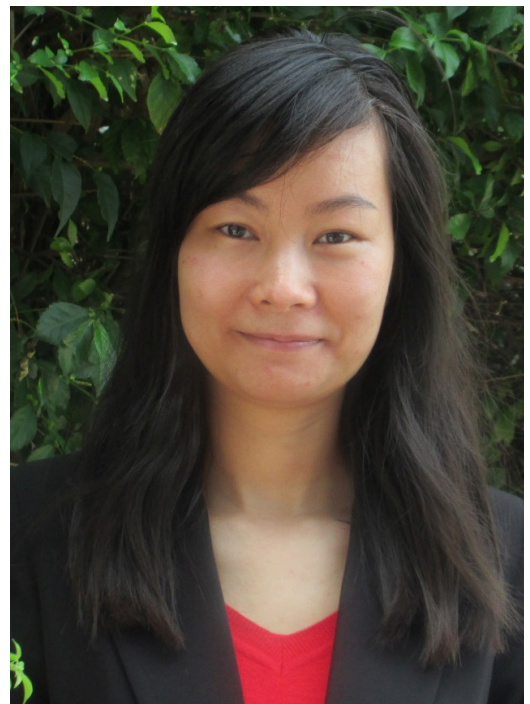


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CGIO was established by the NUS Business School in 2010. It aims to promote relevant and impactful research on governance issues that are pertinent to Asia, including corporate governance; and governance of family firms, state-linked companies, business groups, and institutions. CGIO organises events such as public lectures, industry roundtables, and academic conferences on topics related to governance.

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About This Report

This report is a three-year joint collaboration between the Centre for Governance, Institutions and Organisations at NUS Business School and the Chartered Institute of Management Accountants. The focus of the research initiative is to conduct studies on State-owned Enterprises in Asia.

The second of three editions, this report is on Vietnam and the role and impact of its state sector on the economy.

The first report was about Temasek Holdings, its ownership and governance of Singapore-listed Government-linked Companies and Government-linked Real Estate Investment Trusts. The third report will be on China and its reform of state companies.

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Centre for Governance, Institutions and
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&
Chartered Institute of Management
Accountants
April 2015

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Organisations (CGIO)**

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