Reform of State-Owned Enterprises

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Vietnam: Retaining Stability, Regaining Competitive Edge, Reaping Growth Potential

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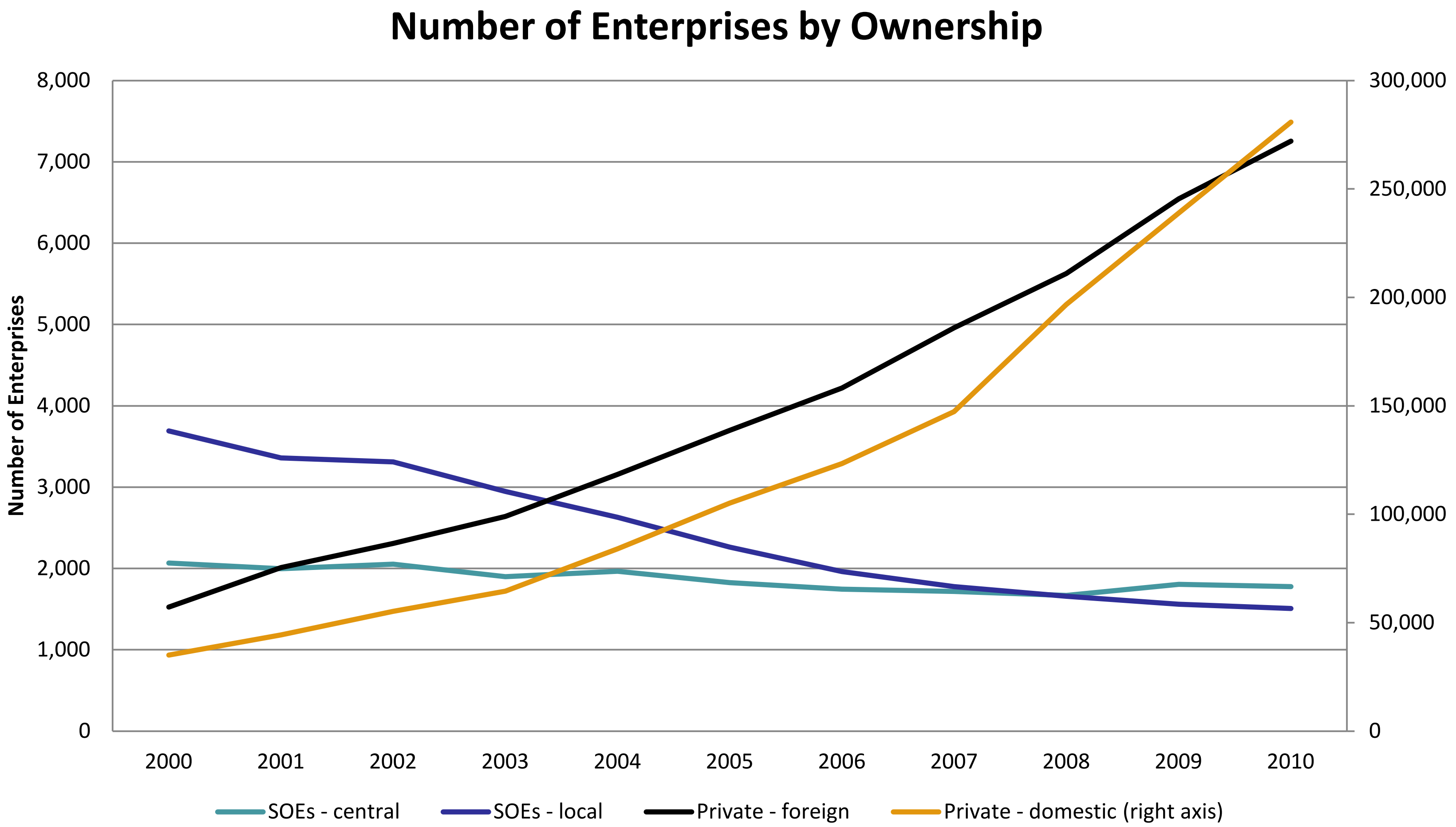
Vietnam should resume the path to becoming an emerging market

- Vietnam has experienced strong growth as a result of past reforms, including economic liberalization
- Recently, however, growth has slowed as distortions accumulated
- To reap its full growth potential, a second wave of reforms is now needed
- This includes:
  - Creating a level playing field for private and state-owned enterprises (SOEs)
  - Restructuring remaining SOEs

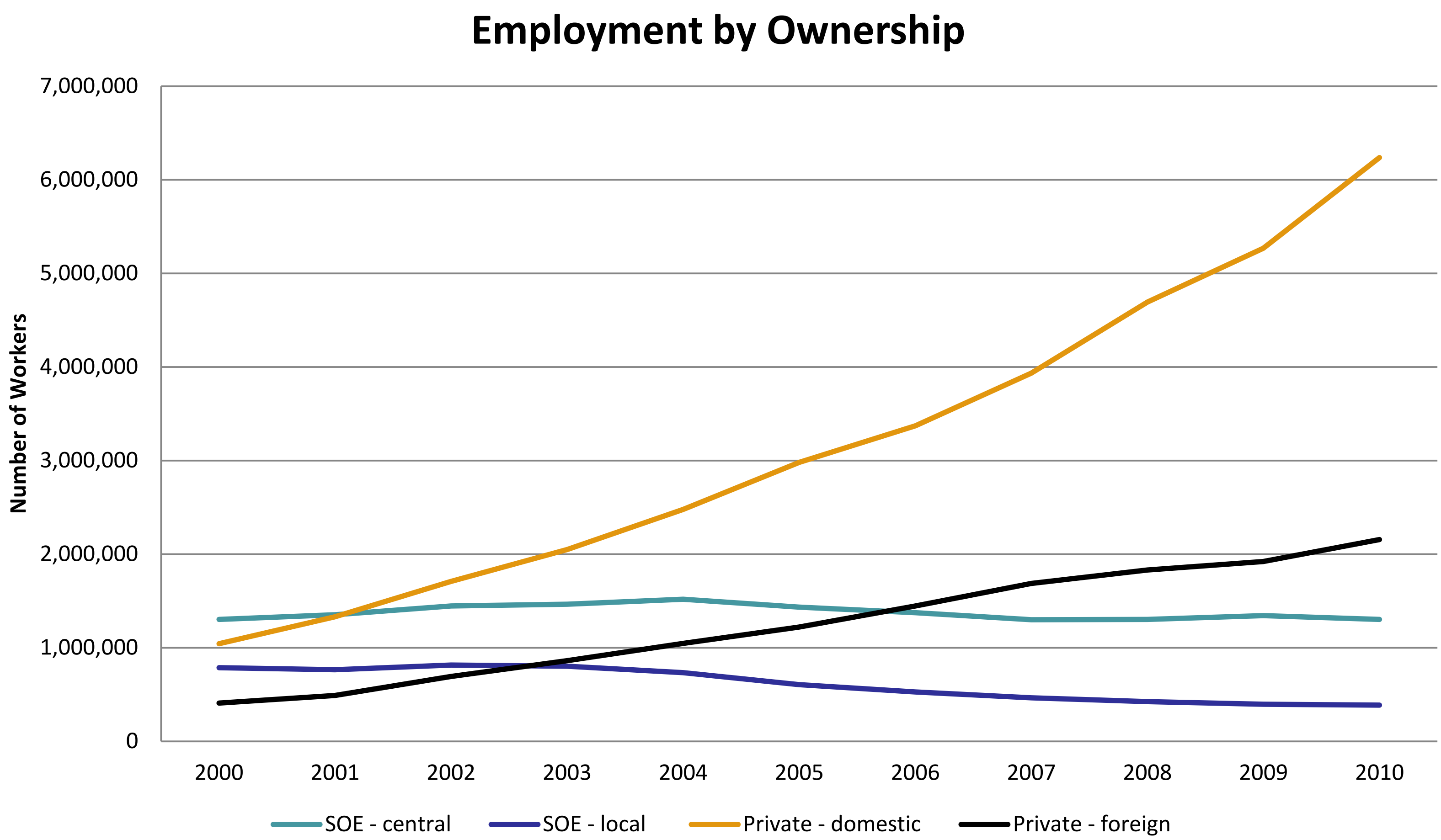
The authorities are already taking initial steps in this direction

- SOE restructuring is one of three strategic goals in the 2011-2015 Five-Year Plan
- SOE Restructuring Plan introduced in July 2012
  – Roughly 1,200 remaining 100 percent SOEs, mostly owned by central government
- Purpose of this presentation:
  – Analyze SOE performance and the authorities' proposed SOE reforms
  – Offer supplementary recommendations on how to improve outcomes

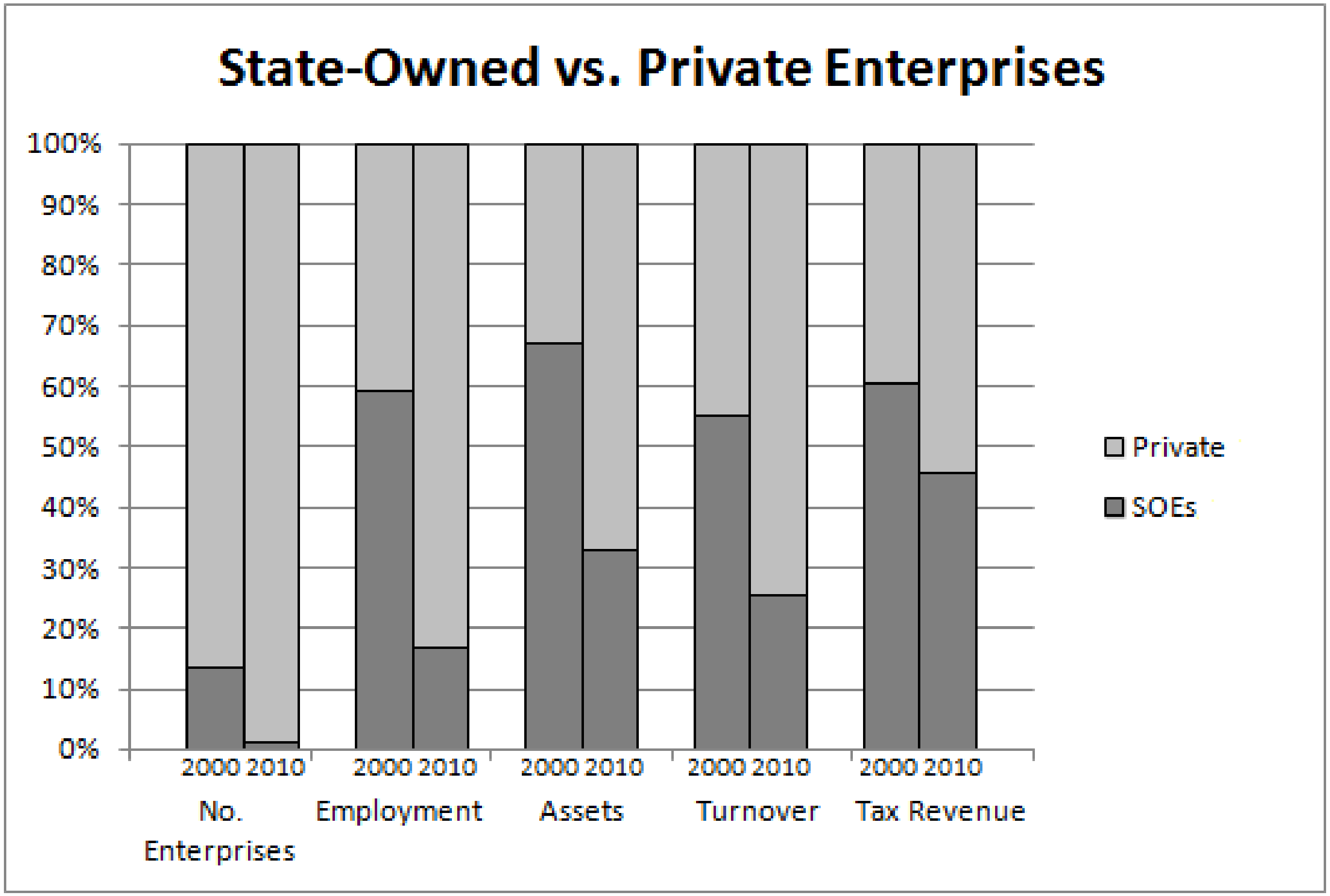
Vietnam has been very successful in promoting private sector development…



…which greatly stimulated employment growth



Nonetheless, SOEs still account for a large share of employment, assets, output and taxes.



The Ministry of Finance publishes aggregate data on SOEs

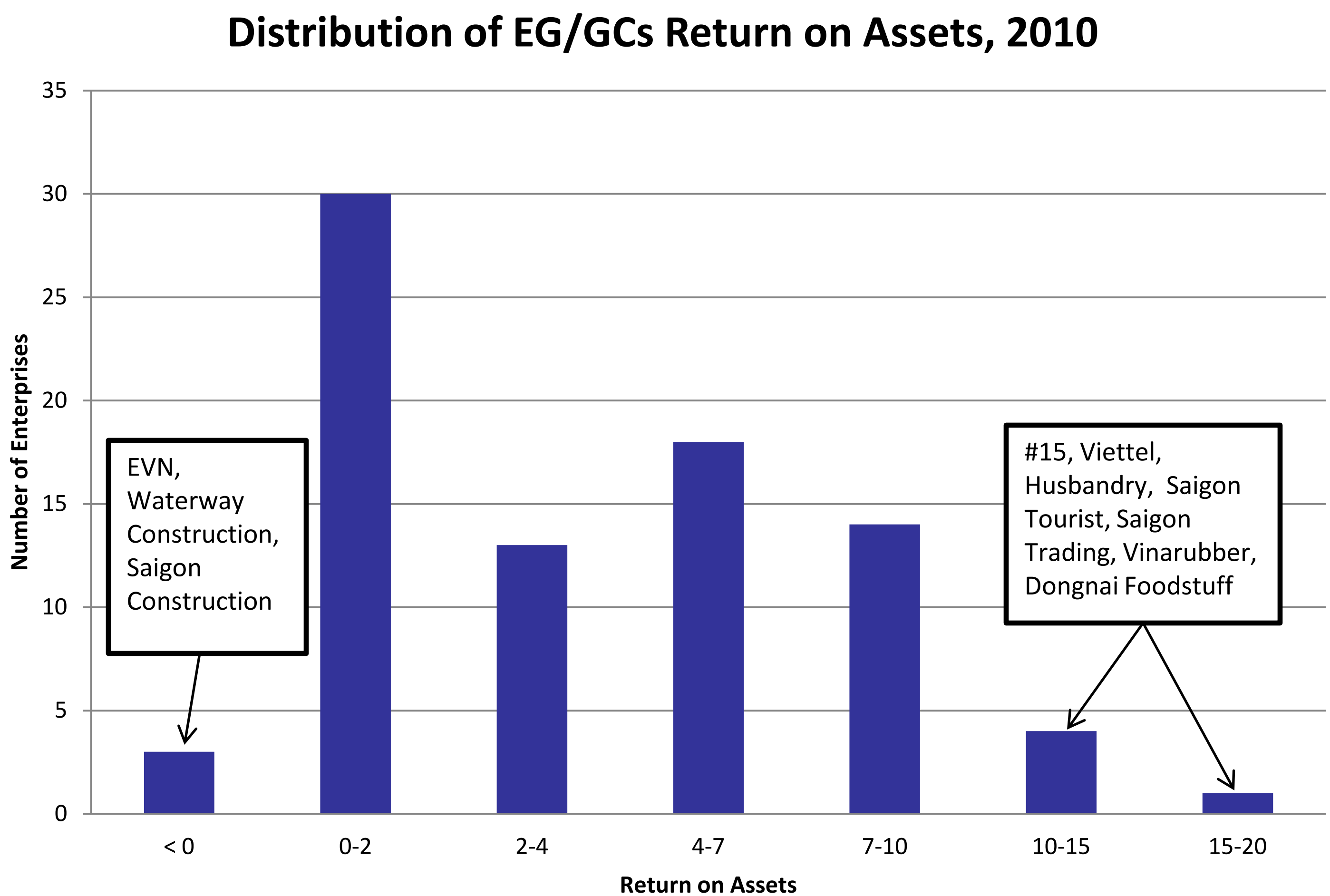
Financial Data for Largest Economic Groups and General Corporations*

VND Billion (unless otherwise noted)

	2006	**2007**	**2010**	**2011**
Total Asset	751,698	767,151	1,799,317	2,093,907
Total liabilities	751,698	767,151	1,799,317	2,093,907
Equity	317,647	406,975	653,166	727,277
Payables	419,991	519,040	1,088,290	1,292,400
Long-term	226,478	262,061		604,191
Short-term	193,933	256,979		688,202
Turnover	504,253	625,027	1,488,273	1,577,311
Before Tax Profit	56,083	67,404	162,910	135,111
Losses			1,116	5,823
Number of enterprises (units)	95	95	85	91
Percent				
Debt/Equity Ratio	1.4	1.3	1.7	1.8
ROA	5.4	6.3	6.8	4.8
ROE	12.7	11.9	18.7	13.9

Source: Ministry of Finance *Excludes Vinashin

SOEs exhibit a wide range of profitability…



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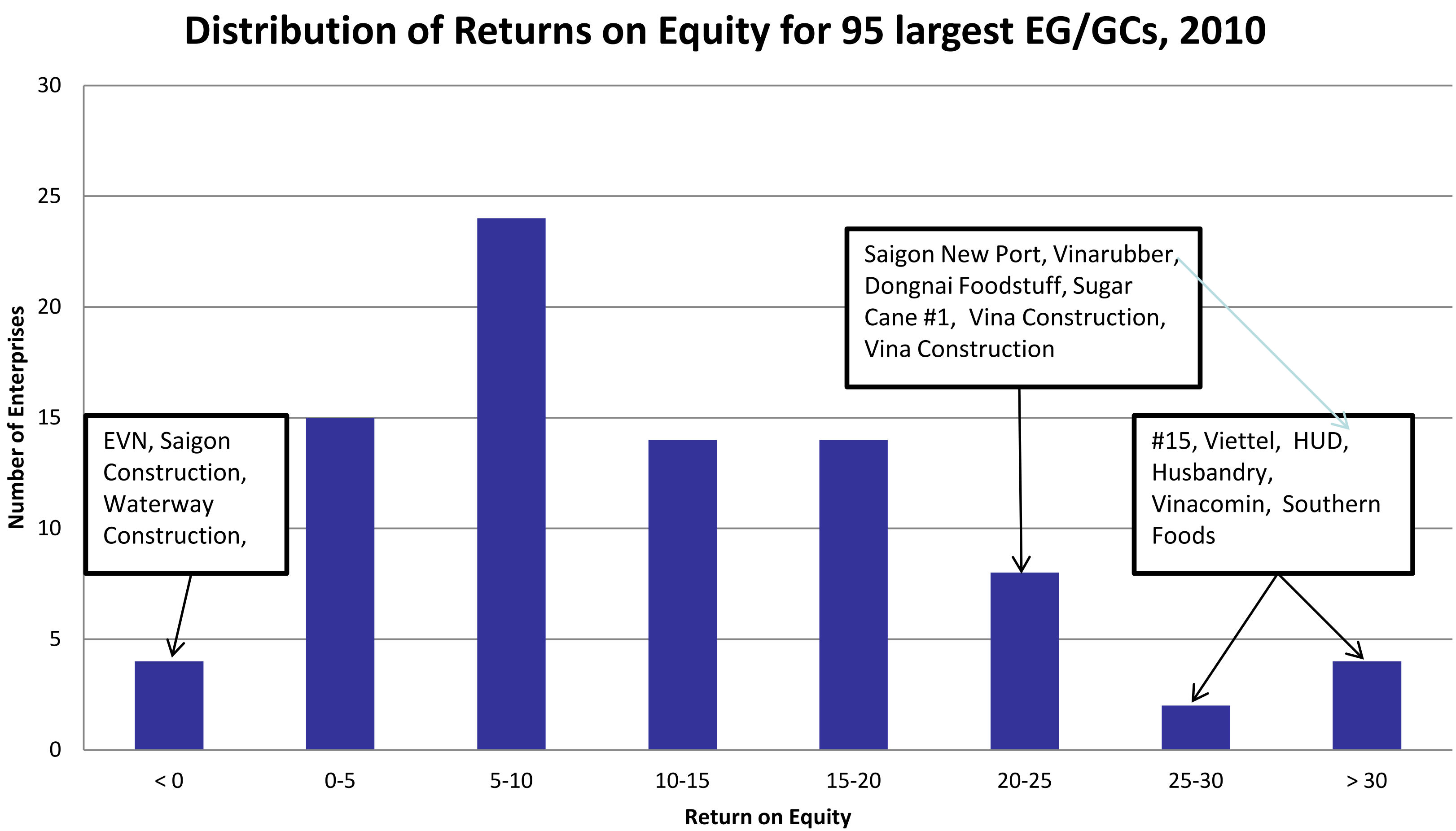
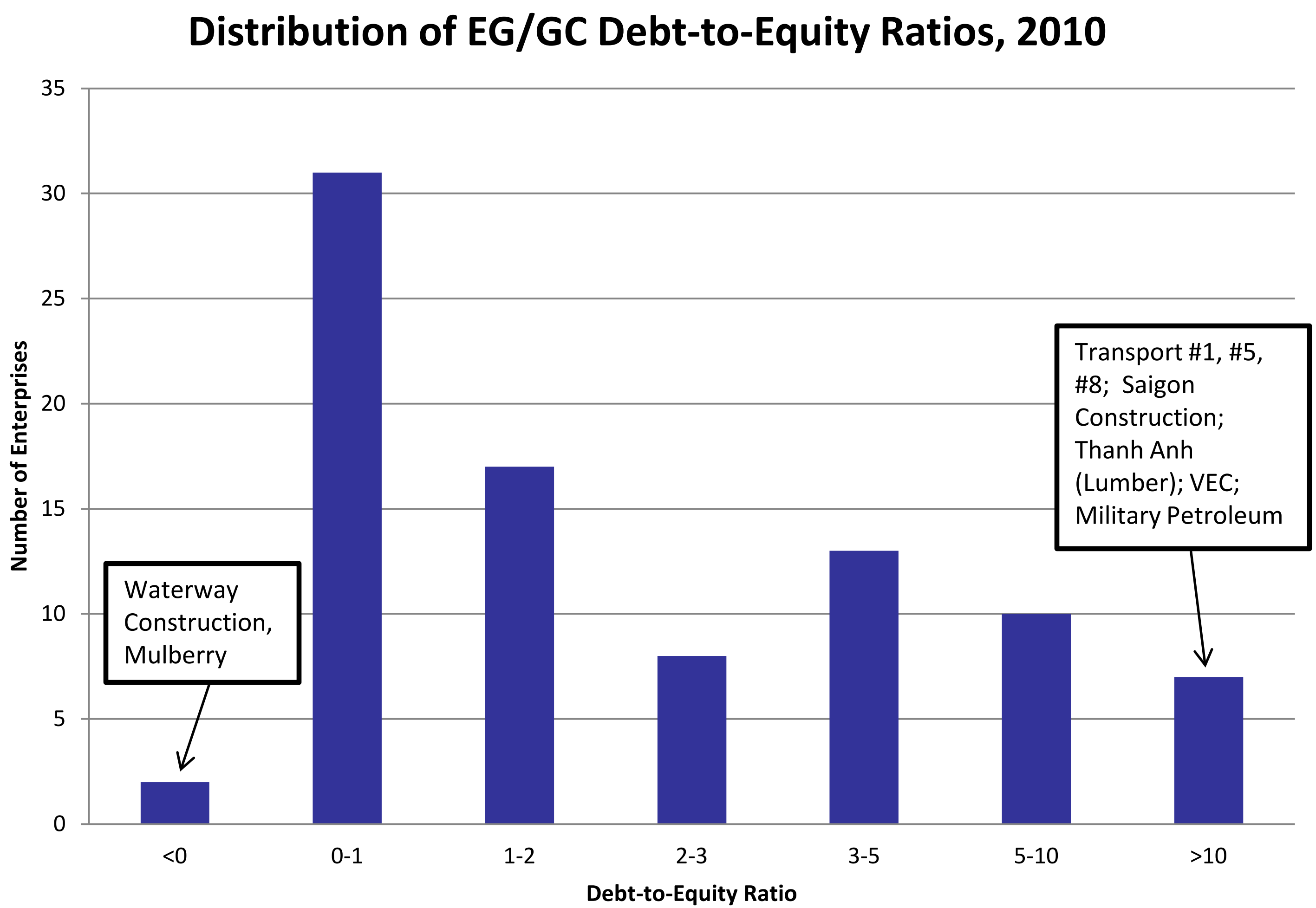


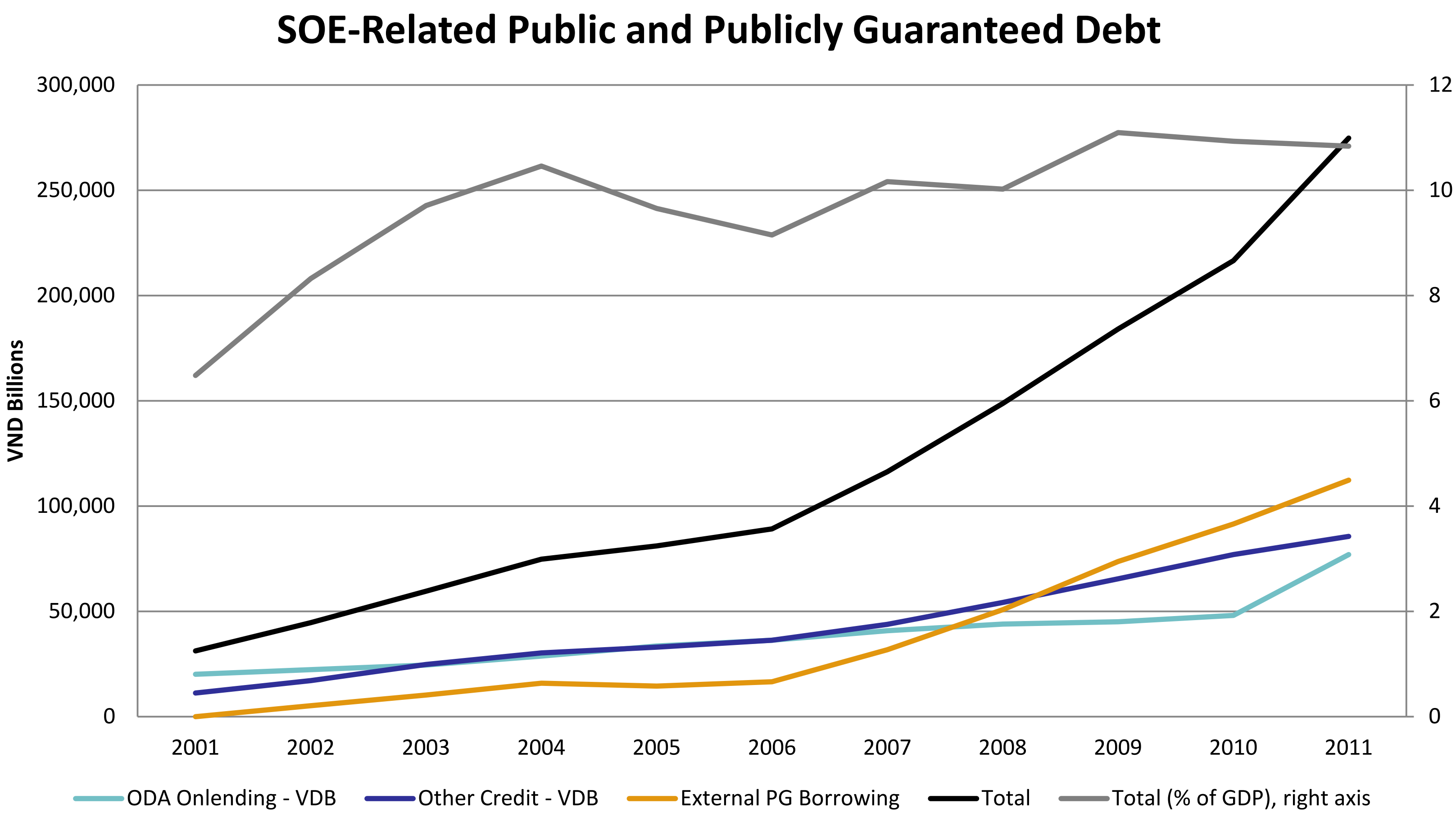
…as well as a wide range of leverage ratios



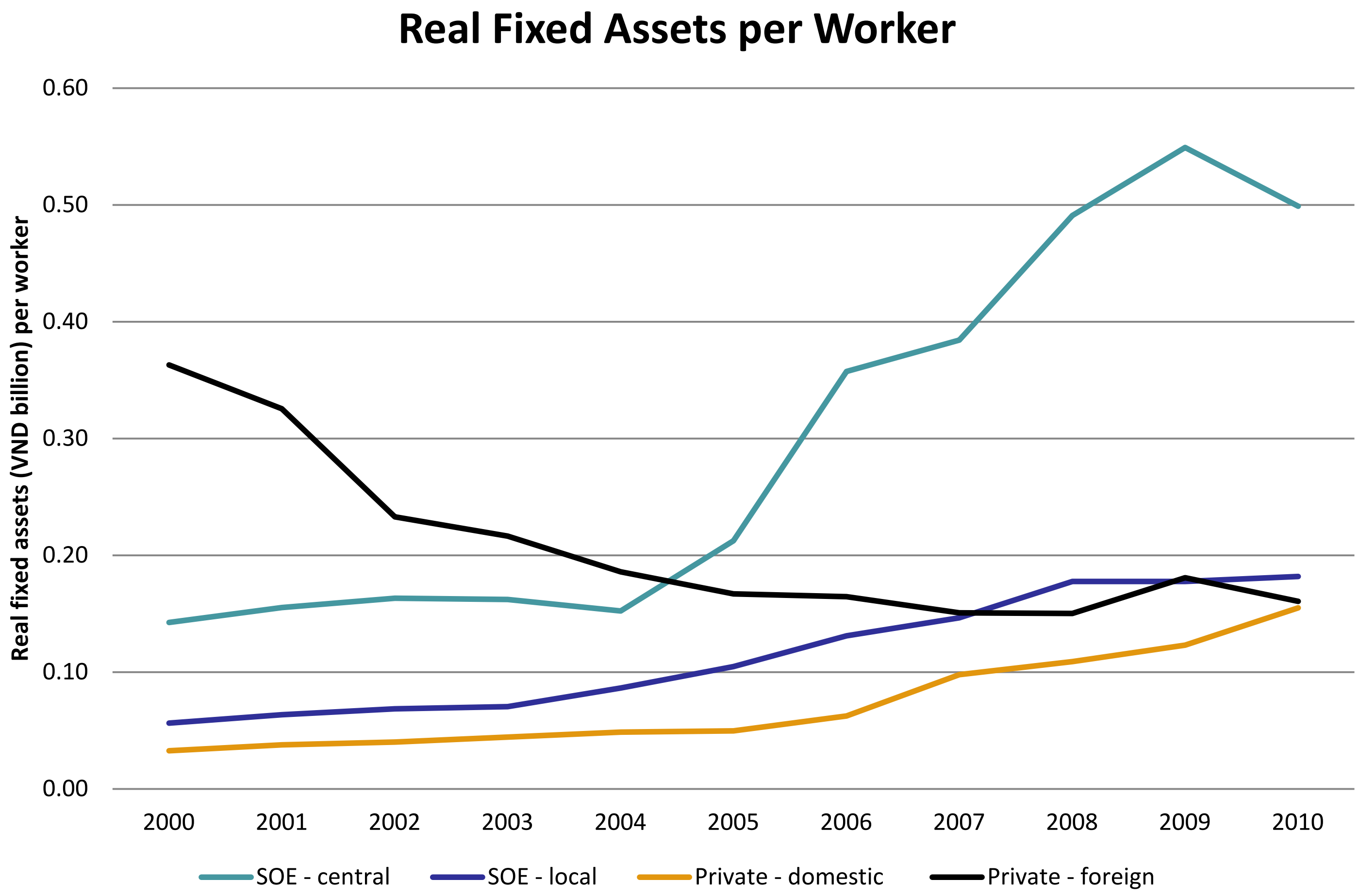
Different SOEs thus have different restructuring needs

- Many SOEs are overleveraged and/or invested in industries hit by downturn (e.g., HUD, Songda, Vinashin, Vinalines)
  - These need downsizing/consolidation
- Other SOEs (e.g., Viettel, Vinarubber, Vinacomin) are highly profitable with low debt
  - High profits may be sign of restricted competition
- Others do not earn a market return due to social mission (e.g., EVN, VEC, Petrolimex)
  - These require fiscal rationalization for sustainability

Since 2000, government-subsidized credit to SOEs has risen sharply



SOEs borrowed to accumulate fixed assets, increasing their capital intensity



During investment boom, many SOEs diversified into non-core areas

- Management extended past areas of competency, with negative impact on performance.
- Finance, real estate especially prominent
  - Banking and property market troubles have hit SOE performance.
  - Captive financial firms lend to affiliates, fueling excess leverage.

EG and GC Investment in Non-Core Businesses

	2006	2007	2008	2009	2010	2011
Total	6,114	14,441	19,840	14,991	21,814	23,744
Banks	3,838	7,977	11,427	8,734	10,128	11,403
Real Estate	211	1,431	2,285	2,999	5,379	9,286
Insurance	758	2,655	3,007	1,578	2,236	1,682
Security	707	1,328	1,697	986	3,576	696
Investment Funds	600	1,050	1,424	694	495	675
Non-core/turnover	1.2%	2.3%	2.4%	1.4%	1.5%	1.5%

Source: Ministry of Finance

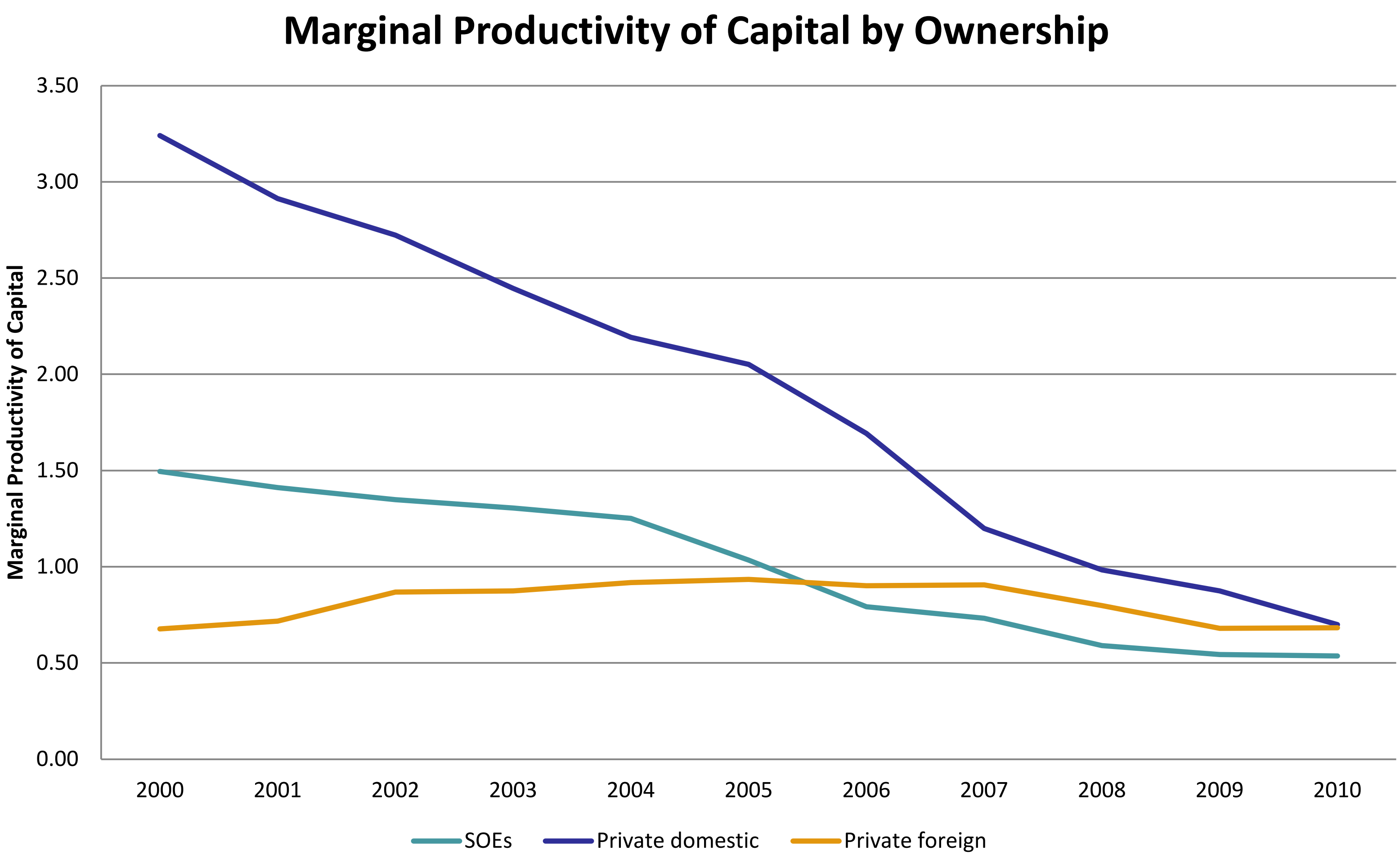
Due to subsidized credit and self-lending, many SOEs are now overleveraged

Financial Data of Largest Economic Groups and General Corporations

Average	2006	2011
Debt/Equity Ratio	1.3	1.8
D/E Ratio (2011)	**Number of EG/GCs**	
More than 3:1	30	
More than 5:1	18	
More than 10:1	8	

- Highly leveraged firms (D/E ratio > 5) are predominantly in construction, transport, real estate.

Overinvestment has resulted in low capital productivity at larger SOEs.



Capital should be reallocated to the private sector

- Production functions were estimated for each sector based on total labor, fixed assets and turnover
- Capital is now approximately 30% more productive in the private sector than the public sector
- Almost 18 percent of fixed assets should therefore be reallocated to the private sector
  - This would produce increase total output by about 1.2 percent.
- This is clearly a rough calculation, but it gives an idea of the extent of the restructuring needed.

SOEs have privileged access to markets as well as inputs

- Competition is often limited
  - To offset trade liberalization, Government also created sectoral conglomerates (e.g., textiles, rubber, chemicals)
  - Some SOEs are in areas with “natural monopolies” (e.g., utilities) or are protected due to “national interest” (e.g., extractive industries)
- Restricted competition produces high profits, but…
- Monopolization can raise prices and does not promote efficient production and innovation

SOEs dominate key industries

SOE Share of Output by Industry (2008)

Sector	SOE Share of Output
Mining	
Coal	97
Petroleum	50
Metal ores	65
Other	36
Manufacturing	
Tobacco	99
Textiles	27
Paper	25
Publishing	75
Chemicals	37
Non-metallic minerals	41
Base metals	28
Electrical machinery	27
Utilities	
Electricity, gas	97
Water	93

Source: CIEM (2011)

Sectors with Highest Concentration Ratios (2009)

Sector	CR3	No. Firms
Oil and gas production	100	7
Broadcasting	89	30
Telecoms	86	354
Postal delivery	80	119
Air transport	76	13
Financial services	67	1519
Insurance	63	n.a.
Cigarettes	58	n.a.

Source: CIEM (2011)

SOEs have closer relationships with government

- Access to public contracts
  - SOEs dominate utilities, transport, construction, infrastructure markets
  - Private firms are “crowded out” by SOEs in some regions (Thang and Freeman, 2009)
- Corruption
  - Corruption limits private industry growth in some regions, but not SOE growth (Nguyen and Van Dijk, 2012)
- Variation in business climate across regions suggests that design of fiscal federalism should be improved.

For some SOEs, social objectives undermine solvency

- For example: EVN
  - Government’s goal of providing affordable energy throughout country produced losses.
  - Addressed in recent restructuring plan
- SOEs making chronic losses due to social objectives should be incorporated into general government accounts.
  - They are really taxpayer-funded, not commercial enterprises
- Or, government may want to seek technical assistance to rationalize these industries.

In general, SOE corporate governance is weak

2012 SOE Reform Plan

- Unclear, overlapping lines of state authority
- No clear division between ownership and regulation responsibilities of state
- Lack of adequate oversight of SOE managers, investment plans
- Inadequate internal and external financial reporting

Weak corporate governance (cont'.d)

Further issues not mentioned in SOE Reform Plan:

- Unusually, SOE are not required to remit profits to the Treasury.
  - Capital user fees abolished 2002
- This weakens financial discipline and encourages inefficient (re)investment.
- It also gives SOEs an advantage over private sector firms, which must produce a market return on equity for owners.

It is common practice across Asia for SOEs to distribute dividends to the government.

SOE dividends as a Share of Total Revenue

Country	Year	Dividends (%)
Bhutan	2009	25.7
China (Mainland)	2010	2.4
China (Hong Kong)	2010	2.1
India	2009	3.4
Maldives	2011	9.3
Mongolia	2011	2.0
Papua New Guinea	2010	3.7
Thailand	2011	4.3

Source: GFS, IMF staff

SOE financial problems have created significant fiscal risks

- Publicly guaranteed debt related to SOEs is about 15% of GDP (2011)
  - This debt is already reflected in PPG debt level, but cost of financing could rise if SOEs default
- Can non-guaranteed SOE debt also become a public liability?
  - E.g., Government's guarantee of $2.2 billion of Vinashin's restructured debt
  - Total SOE debt (2011): 51% of GDP

Other sources of fiscal risk from SOEs include:

- Labor redundancies
  - In previous restructurings, average redundancy rate of inefficient firms was 13% of workforce (CIEM, 2005)
- Capital losses
  - In restructuring SOEs, government will have to realize losses and/or impose “haircuts” on creditors
- Tax collections
  - As government becomes more dependent on private firms for revenue, compliance rates may fall

Recommendation: Improve transparency and accountability

- Quantify fiscal risks from SOEs and SOE restructuring
- Rationalize public service fees
- Publish annual financial statements
  - Ultimately, SOEs belong to taxpayers, who have a right to see their finances
  - Aggregate data can conceal significant losses as well as excessive profits

Recommendation: Create a level playing field for private enterprise

1. End subsidized credit for SOEs
2. Require profitable SOEs to pay dividends to the state
3. Deconcentrate state-dominated industries
4. Reform public investment procurement process
5. Reform system of fiscal federalism

Recommendations: Promote efficient SOE restructuring

- Government plan has many sound measures
  - Clarify and strengthen government oversight
  - Spin off non-core assets
  - Improve accounting and controls
  - Improve and enforce the bankruptcy code
- Additional measures:
  - Establish resident expert committee on equitization
  - Clarify legal treatment of SOE losses
  - Consider broader equitization than provided for in SOE restructuring plan

Recommendations: Promote efficient SOE restructuring

- Government plan classifies SOEs into 3 groups:
  - 100% state owned (defense, infrastructure, power, publishing) (40%)
  - Majority state owned equitized firms (mining, communication, finance, transport, health) (50%)
  - Chronic loss-making firms for consolidation or liquidation (10%)
- Relative to other countries' privatization efforts, Vietnam's has been relatively cautious.
  - Large share in SOEs retained by government
  - Participation of outsiders, takeover threat thought to be critical to promoting efficiency.

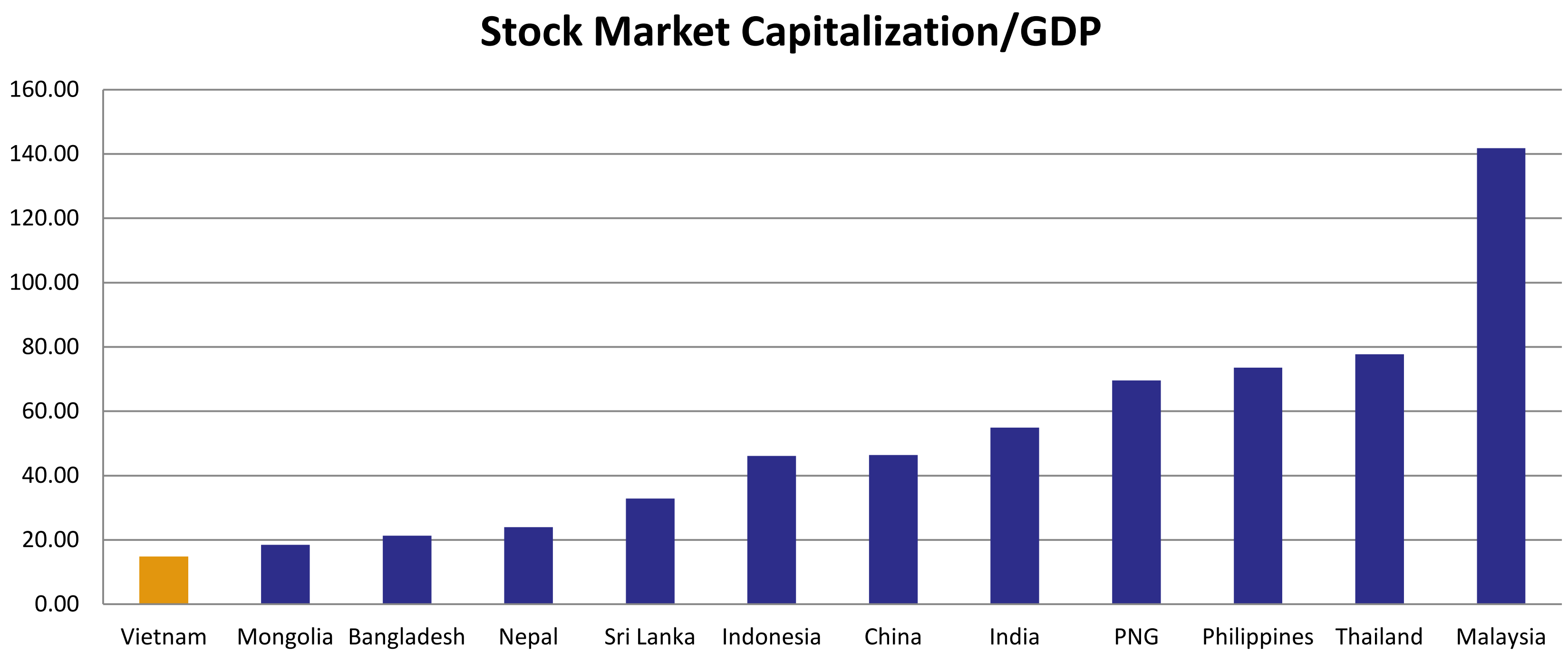
Vietnam’s government has retained a larger share in SOEs than most transitional countries

Average Allocation of Shares in Restructured Enterprises

Country	Year	State	Insiders	Outsiders
Vietnam	2004	38.1	46.5	15.4
Georgia	1997	23.3	64.4	12.4
Kazakhstan	1997	16.1	37.6	46.3
Kyrgyz Republic	1997	5.6	70.8	23.6
Moldova	1997	23.8	38.0	38.2
Russia	1997	14.7	59.6	25.7
Ukraine	1997	15.4	61.5	23.1

Source: Loc et al. (2006)

Equitization and improved corporate governance can help develop Vietnam's stock market



- While the number of listings in Vietnam is about average for comparable countries, market capitalization and turnover are low.
- A deeper equity market will in turn facilitate restructuring.