THE VIETNAMESE STOCK MARKET

By Roberta S. Karmel

Thirty years ago, I never imagined I would be visiting Vietnam and be warmly welcomed as an American, witnessing a nation enjoying economic growth and increasing prosperity, despite some of the lingering ill effects of Agent Orange in the countryside. Yet, last month, as part of a delegation from the Financial Women's Association, I had the good fortunate to travel to Vietnam and meet with government officials and others and learn about business developments and Vietnam's booming stock market.[i[i]] It is noteworthy that the United States is Vietnam's top trading partner, and its second biggest investor after Taiwan.

Vietnam's GDP is rising dramatically, its foreign direct investment is rapidly increasing, and its stock market is soaring. On November 7, 2006, Vietnam was officially recognized by the international community as the 150th WTO member. Vietnam is Asia's second fastest growing economy after China, and it has been forecast that Vietnam will become the world's 17th largest economy by 2025. Although the country has been a one-party communist state since 1976, Vietnam has eased restrictions on private enterprise and is selling off many state owned enterprises ("SOEs") to the public. These offerings are not referred to as "privatizations" for ideological reasons, but rather are called "equitizations." In 1986, Vietnam launched the Doi Moi (or Renovation) intended to transition the country from a centralized economy to a socialist-oriented market economy. These reforms have borne fruit.

In 2006, Vietnam's stock market index surged 145% and in the first three months of 2007, the index rose another 60%. It should be understood that the Vietnamese stock market started from a very low base of 22 listed companies two years ago with a market capitalization of $144 million. Confronted by such a hot stock market, the government authorities are trying to cool the market without discouraging foreign investment, but one of the reasons for the market's momentum is that the government's sale of SOEs is proceeding very slowly and there are serious limits on the percentages of non-governmental investors in these SOEs once they are equitized.

Vietnam's securities markets are supervised and essentially managed by the State Securities Commission which is part of the Ministry of Finance. A Law on Securities (23/08/2006) was adopted in June of 2006 to facilitate the development of the securities market speedily and sustainably. The law covers the regulation of listing and trading securities; the State's role in administering and inspecting the securities market; the public offer of securities; the disclosure and corporate governance of public companies; the organization of trading markets; depository, clearance and payment facilities; investment management and fund companies; information disclosure; inspections and dispute resolution. The extent to which this law and its administration will be adequate will probably be tested by the stock market's resiliency in the event of a serious market break or scandal. Since the adoption of the Law on Securities, Vietnam has experienced only a bull market. Indeed, both the proverbial bull and bear statues in front of the Ho Chi Minh Stock Exchange look remarkably tame, and the bear resembles a teddy bear more than a fierce and dangerous animal.

The State Capital Investment Corporation represents the State as an investor where the state retains a majority interest in SOEs sold on the public securities markets. This organization is modeled after Temasek Holdings, the investment arm of the

Singapore government, which is one hundred per cent owned by the Ministry of Finance of Singapore. The State Capital Investment Corporation is working with the World Bank, the IMF and similar organizations to devise a corporate governance model for Vietnam. Similarly, a major international accounting firm is assisting Vietnamese companies to adjust to international accounting standards. About 400 SOEs have been sold; eventually there will be over 1,000 flotations. Targeted industries for public offerings are infrastructure, technology, education, medical, financial services and oil and gas.

Unfortunately, many SOEs are conglomerates without much business rationale. Although there has been an ongoing reform of SOEs for about twenty years, and the number of SOEs has been reduced from approximately 12,000 to approximately 5,000, of which 3,000 have been equitized, the remaining 2,000 SOEs account for about forty per cent of GDP. The Chairwoman of the State Capital Investment Corporation advised our delegation that her agency works to restructure the SOEs that are equitized and bring their corporate governance and financial accounts and performance up to international standards. But although officials are aspiring to meet international standards, the reality on the ground is limiting because of the rules about stock ownership and the manner in which SOEs are floated.

In order to be equitized, a company must be transformed from a licensed company with no stockholders into a joint stock company, with at least three stockholders. Only forty-nine percent of the equity of any SOEs, and only thirty percent of the equity of financial institutions are allowed to be sold to shareholders. Further, employees are offered discount shares before the offering, and when these shares are offered, there are not yet audited financials. These discount shares are sometimes traded in an “over-thecounter" or gray market before the public offering and no one knows how big or active this market is. In view of the limitation on the percentages of stock that can be publicly sold, and the practice of conducting an audit of a SOE after discount shares are given out, the government may change the percentage of shares that actually will be sold after the discount shares are tentatively distributed. Following the audit, the balance sheet frequently decreases. An important purpose of the audit is to ensure that the government receives good value for its sale of shares in a SOE. Although directors serve at the pleasure of their government ministries before and after the equitization of a SOE, it appears that some progress regarding corporate governance and better financial performance nevertheless results from public offerings. The reasons are that the government pressures the managers to perform, greater transparency curtails corruption, and managers have an equity participation in their enterprises.

There are two stock exchanges in Vietnam, one in Hanoi and one in Ho Chi Minh City (formerly Saigon and still called Saigon by many who live there). The Ho Chi Minh stock exchange was inaugurated in July 2000 with trading in two equity issues. Today, about 110 companies are listed on Vietnam's two exchanges. About eighty per cent of the stocks trading on the exchange are SOEs. Although the sale of SOEs is controlled, there do not appear to be restrictions on the flotation of enterprises that were formed and operated in the private sector. The Ho Chi Minh exchange operates in a three session periodic call auctions according to price/time priority. The trading unit for equities is ten shares. Settlement is on a T plus three cycle. Companies can list in Hanoi if they have been profitable for one year; in Ho Chi Minh if they have been profitable for three years.

After a company is listed, it is supposed to file quarterly financial reports, but there are no penalties for failure to file reports.

In order to trade on an exchange in Vietnam, the investor must have a custodian account in the country; foreigners are allowed to have such accounts. Approximately twenty per cent of the equity on the stock market is owned by foreigners. This has caused some concern about potential capital flight if the market should experience a down turn. But it appears that capital has been raised by funds for investment in Vietnam that has not yet been able to be invested, so there is a pool of capital for future SOE flotations, or to cushion a down turn. We heard contradictory estimates of the P/E ratios for Vietnamese listed stocks. Although the general P/E ratio is probably in the high forties, the real high flyers are the large equities at the top of the market; valuations of mid-sized and smaller companies are not so outsized.

In 2010, the Vietnamese Stock Exchange is scheduled to equitize and go public. At that time it is contemplated that the Securities Commission will become independent of the Ministry of Finance. It is anticipated that member firms and funds, including foreign funds, will own the exchange after it goes public. There are fifty-five securities companies, mostly private, some connected to state owned banks. Most of these companies were recently organized. In order to join the WTO, Vietnam passed about 200 new laws, including a Law on Investment. This law provides, in Article 4, that "investors shall be permitted to invest in all sectors and in all industries and businesses which are not prohibited by law," and that "the State shall provide equal treatment before law to all investors from all economic sectors and as between domestic investment and foreign investment." Global banks are pushing into Vietnam. Foreign ownership of local banks is capped at thirty per cent; and no single foreign entity can hold more than ten percent, but it is expected this cap will be raised to twenty per cent soon.

Despite significant legal reform, Vietnam does not enjoy a rule of law as that term is understood in the United States and other developed countries. Many new laws have been enacted, but enforcement is questionable. Judges are not well trained and cases drag on interminably. There are only about 2,000 lawyers in the entire country. There are some arbitration mechanisms with an appeal to the Supreme Court.

Among the strengths of the Vietnamese economy are its young, well educated and energetic population. Half of the population is under thirty and literacy is ninety-four per cent. But there is a serious shortage of well educated middle managers and employment hopping seems to be rife. There are serious infrastructure problems, like frequent brown outs. In the streets, there are electric and other wires laced together and hanging all over. As might be expected in a centrally planned economy, there is a lack of transparency and too much corruption. These problems are being addressed, however, and it appears that the current government is committed to pulling back from the organs of State and overhauling the educational system. Politics are bottom up so the Peoples Committees in the villages have a lot of autonomy.

The process by which Vietnam is developing its stock market is in many respects similar to the manner in which China created its stock market. In addition, the State Capital Investment Corporation is modeled after the highly successful, although occasionally controversial, Temasek Holdings of Singapore. The extent to which these Asian models will succeed in establishing a deep and liquid stock market that will attract domestic and foreign capital and assist the development of Vietnam's economy remains to be seen. But the Vietnam experiment in equitization deserves to be watched. The will of the Vietnamese people to succeed is obviously great as the country has made amazing strides after its reunification thirty years ago following years of colonization and war.

The information in this column is based on various briefings by government officials and private sector business men and women in Vietnam, news reports in the Viet Nam News, an English language daily and some other news articles. Vietnamese government web sites in English were also utilized.

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