

Corporate finance and state ownership in Vietnam: Capital structure, investment behavior and profitability of listed companies

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Abstract

In 1986, Vietnam started the *Doi moi*, which is a comprehensive reform programme of economic and many other fields. It marked the end to the centrally-planned economy, opened a new era to the Vietnamese economy – an era of socialist-oriented market economy, diverse forms of ownership, industrialization and opening of the economy. An important component of these economic reforms was the reform of state-owned companies (SOCs). The aim of these reforms is to improve the performance, competitive capability and reduce the number of SOCs. Among other measures, equitization has been the main instrument to reform the SOCs quickly and effectively. The Ho Chi Minh Stock Exchange (HOSE) was opened in 2000 and the Hanoi Stock Exchange (HASE) was opened in 2005. The stock market has grown rapidly though not stably.

This dissertation investigates the capital structure and its impacts on investment behavior as well as the profitability of listed companies in Vietnam with an emphasis in identifying the characteristics of state-controlled companies in order to assess the effects of the economic and corporate reforms in Vietnam since the *Doi moi*. Whether the corporate sector, as a major domestic investor, can mobilize funds efficiently or not is critical in facilitating the transition to a market economy. In particular, because listed companies are surrounded by a more developed institutional environment in comparison with other companies, studying these companies helps to evaluate the effectiveness of the reforms in Vietnam. Moreover, one feature of equitization in Vietnam is that the state still holds decisive voting rights in many

equitized SOCs, thus identifying the characteristics of corporate finance of such state-controlled companies is also an interesting topic in order to assess the reforms of Vietnam.

The thesis has seven chapters. The details of Chapter 1 to Chapter 7 are as below.

Outline of Chapter 1

Chapter 1 provides an overview of the reform of state-owned companies (SOCs) as well as an overview of stock markets, listing companies and the banking sector in the context of the economic reform under the *Doi moi* policy in Vietnam. The equitization programme in Vietnam started in 1992 and by the end of 2011 about 4,000 SOCs had been equities. The listing norms of the HOSE are stricter than those of the HASE.

The main characteristics of the economic reform in Vietnam are (1) the same as those of China, the economic reform in Vietnam started from the reforms in the agricultural sector, then in the corporate sector, the promotion of foreign trade and attraction of FDI; (2) most of the equitized SOCs are small sized, the remaining 1,300 fully state-owned companies are the largest ones; (3) the development of Vietnamese stock markets is linked with the equitization process; (4) the stock markets in Vietnam are under-represented by institutional investors; (5) the portion of SOCBs loans to the economy fell year by year, to 51.7 per cent in 2011, and the portion of total outstanding loans to SOCs also declined steadily, to 16.7 per cent in September 2012; (6) The participation of foreign investors both in terms of FDI and in stock market plays an important role in the reform process in Vietnam.

Outline of Chapter 2

Chapter 2 introduces the characteristics of the ownership structure, corporate finance and corporate governance of listed companies in Vietnam.

One of the significant features of the ownership structure of listed companies in Vietnam is that the state remains a dominant shareholder, which gives such companies a privilege over

other companies in raising funds in the context that the four big state-owned or state-controlled commercial banks still provide most of the loans to the whole economy, but may be less inactive in investment or less effective in operation. Besides, along with the high development of the Vietnamese economy, the penetration of foreign investors into the stock markets is another characteristic of the ownership structure of listed companies in Vietnam, which also has effects on the activities of these companies.

Outline of Chapter 3

Chapter 3 reviews both the theoretical and empirical literature on capital structure and its impacts on investment and the performance of companies in the context of corporate reform as well as describes hypotheses, models and data set for the empirical analyses that are conducted in the next three chapters.

This chapter sets five hypotheses to assess the results of economic reforms and corporate reforms in Vietnam in general based on modern corporate finance theories. As for the determinants of capital structure, companies' debt ratios are expected to have a positive relation with corporate tax and bankruptcy risk, negative relation with non-debt tax shields according to the trade-off approach, and positive relation with collateral, negative relation with internal funds according to an agency cost approach. Regarding the relation between capital structure and investment, listed companies in Vietnam may cope with overinvestment because of the easy lending of banks in the boom period or underinvestment because of the cautious lending of banks in the after-boom period. As for the relation between leverage and profitability, in Vietnam, the creditors' monitoring of a company's business operations is not sufficient and the corporate governance of the borrowing company is inadequate, thus the company may use the loans ineffectively. Regarding the impacts of leverage on investment and growth opportunities, there are possibilities of underinvestment, overinvestment, or soft

budget constraints among listed companies in Vietnam.

This chapter also presents hypotheses about the impacts of state ownership and foreign ownership on capital structure, investment, profitability and growth opportunities. State-controlled companies may have weaker incentives to adjust their debt ratios to attain tax savings, lower bankruptcy risk due to implicit guarantees of the state, easier ability to access state-owned bank loans regardless of their collateral due to their closer relationships with state-owned banks. State-controlled companies may be more active in investing than other companies due to their function as a tool for implementing government policies, or make less use of good investment opportunities due to their less profit-oriented characteristic. They also may have higher profitability due to their advantages in raising funds from banks, or lower profitability due to being less independent from the state in terms of business management. These companies may have more severe problems of soft budget constraints, which is often seen in transitional countries. Foreign-affiliated companies are assumed to have lower debt ratios, higher investment ratios and better performance due to their high requirement of information disclosure and strict monitoring over business operations.

This thesis uses three models: (1) Capital structure and investment; (2) Capital structure and profitability; (3) Capital structure, growth opportunities and investment that are formed from four equations of capital structure, investment, profitability and growth opportunities. Three estimation methods of OLS, 2SLS and 3SLS are used to estimate these three models. Cragg-Donald statistic and Durbin-Wu-Hausman Test are conducted to check the weak instrument variables and endogeneity for using 2SLS and 3SLS method.

Outline of Chapter 4

Chapter 4 investigates the capital structure and investment activities of listed companies in Vietnam, using panel data covering the six-year period 2006-2011 of 435 companies listed on

the HOSE and on the HASE.

This study identified some key features of the fundraising structure and their effects on the investment behavior of listed companies in Vietnam. In terms of fund mobilization and corporate financing, the economic reforms implemented by the Vietnamese government, which aims to create an economic system based on market mechanisms, have achieved some of their goals. However, there are still several limitations, such as the opaque relationship between state-controlled companies and government banks, financial restrictions on investment activities, and inactive investment of state-controlled companies.

Outline of Chapter 5

Chapter 5 conducts an empirical analysis on the capital structure and its impacts on the profitability of 435 listed companies in Vietnam, using panel data of two periods of 2006–2008 and 2009–2011.

The estimation results show that, firstly, compared to Vietnamese small- and medium-sized enterprises, the capital structures of listed companies matched better the features of standardized corporate financing theories. Secondly, however, weak corporate governance and insufficient creditors' monitoring influenced the listed companies to excessively borrow in both periods before and after the boom. Thirdly, the state-controlled companies listed on the HOSE are likely to have an advantage over other companies in accessing loans and earning profits even after the boom period. Fourthly, while foreign-affiliated companies were not conspicuous in terms of profitability during the boom period, they showed their superiority through better production technology and management in the after-boom period.

These findings suggest that reforming the Vietnamese market requires the development of a system that ensures information transparency and independent corporate governance, enhances financial openings, and increases privatization of state-owned companies, including

those in the banking sector.

Outline of Chapter 6

Chapter 6 is a study on the influence of capital structure on investment activities and growth opportunities using panel data covering the six-year period of 2006–2011 of companies listed on the HOSE.

The estimation analysis revealed two major findings. Firstly, in general, there is an over-investment problem among listed companies in Vietnam and debt financing minimizes this problem. Secondly, the state-controlled companies face a soft budget constraint problem, which is common in transition economies.

These results imply that state-owned banks in Vietnam seem to impose fewer restrictions or lower levels of monitoring on loans to state-controlled companies. Therefore, further reform in the banking sector and in state-controlled companies and further disclosure of corporate information are needed to resolve the opaque collusion between state-controlled companies and state-owned banks and to protect outside creditors.

Outline of Chapter 7

Chapter 7 summarizes the main contents of the thesis, discusses the findings and implications, and indicates some limitations of the thesis, which suggest some topics for future researches.

According to the empirical analyses, the overall picture of corporate finance of listed companies in Vietnam becomes obvious. Firstly, financing structures of non state-controlled companies have features that conform well to economic theories and a market economy. Secondly, the state still retains a controlling shareholding in many former state-owned companies and has controlling rights over these firms' activities, which helps these companies make use of their close relationship with the government to access loans under

preferable conditions, although their fund-using activities remain inefficient. Thirdly, five big state-owned or state-controlled commercial banks are still lending to most of the domestic demand, and they still impose preferable conditions and less strict monitoring on loans to state-controlled companies. Fourthly, fund-raising through the stock market is still undeveloped, and the fund-raising activities of listed companies in Vietnam rely on debt financing such as bank loans.

These empirical analyses have some implications. Contrary to small and medium enterprises (SMEs), the capital structures of listed companies in Vietnam are relatively well matched to the features of standardized corporate financing theories. However, the market environment surrounding Vietnamese listed companies still has many problems that need to be addressed, such as information asymmetry, institutional reforms including the development of a system that ensures independent corporate governance and transparency of information, the acceleration of privatization of state-owned companies and banking sector.

The data set of the empirical study was unbalanced panel data for the period of 2006-2011 of companies listed before 2009. Companies listed after that and data for the period after 2011 should be added to the data set. Besides, the debt ratios' content in the estimation was measured roughly through fund procurement indexes. In Vietnam, funds procurement typically proceeds not only through commercial banks but also through institutional financing systems, and allocation may thus be determined in complex ways that involve political factors. Elucidating this point will require a study of the data on the listed companies' bank loans to clarify the relationship between those companies and the banks. Moreover, although this thesis studies corporate finance, it focuses only on the corporate side. However, it is also important to examine the banking sector in studying corporate finance. I intend to conduct empirical analyses of the above-mentioned issues in a future study.