DOUBLE MORAL HAZARD IN STATE-OWNED ENTERPRISES (SOES) IN VIETNAM CASE OF VIETNAM SHIP-BUILDING INDUSTRY GROUP (VINASHIN)

By

Nguyen Thi Bich Ngoc

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of the requirements

for the degree of

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Committee in charge:

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ABSTRACT

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"Moral hazard" originally meant that people with insurance might be more careless when they were insured since they believed that the losses caused by their carelessness would be finally paid by the insurance companies. The term was later used in finance and banking and other areas of economics including government's backing to big firms no matter if they were private and state-owned.

The government's backing to state-owned enterprises (SOEs) in Vietnam is problematic in two ways. First, the financial support is an implicit insurance for firms' careless investment. Second, worrying that the government's backing could lead to moral hazard, Vietnamese government has tried to direct SOEs with top-down intervention and regulations, believing that these actions will limit the risky behavior. The government has supposed that the combination of financial backing and their direction will help SOEs perform well. However, instead of preventing SOEs from making risky decision, heavy intervention makes SOEs rely on the government's direction passively. They believe that the government will be responsible for what they order firms to do. Therefore, the government's intervention doubles the moral hazard in SOEs. This can be explained shortly in the following proposition (1) as the main hypothesis of the paper:

Financial Backing + Top-down Intervention = Careless Decision + Passive Management

The author also looks at the alternative hypothesis that leadership of the SOEs can affect the firm's efficiency in the following proposition (2):

Capable Leadership + Financial Backing + Top- down Intervention = Careful Decision + Active Management

The factor of competition cannot be applied to the situation of Vietnam as SOEs control all major industries. Moreover, the government has intervened heavily in and among SOEs.

The original reason for the paradox in the main hypothesis is that the government has tried to manage SOEs as administrative institutions who receive funds and preferences to follow orders. SOEs were born as policy instruments and have been trapped in their decided role. Consequently, there are few incentives for the board of directors to focus on the performance of SOEs.

Vietnam Ship-building Industry Group (VINASHIN) has been supported by Vietnamese government with easy access to financial recourses and favorable regulations since its establishment in 2006. However, contradict to the government's expectation, VINASHIN fell into huge debt. It was in insolvency in 2009 and had to go through a restructuring program. After the restructuring program, the government has tried to rescue VINASHIN with more loans and support in 2011 and 2012. In 2012, the government has claimed to supervise the board of directors more carefully.

After VINASHIN's insolvency, a number of experts believe that there should be stricter supervision and direction to new VINASHIN as well as the new board of directors. However, the core solution should be giving more incentives for the new leadership to work effectively and make the firm efficient.

This study will point out how the government's intervention and financial backing to the firm led to VINASHIN's insolvency and its remained problem even after the restructuring program. In another word, the case of VINASHIN is consistent with proposition (1) and rejects proposition (2). Policy implications are discussed in the conclusion.

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I would like to express my deepest thanks to my Major Professor Il Chong Nam, who has inspired me greatly to work with this case study. His lectures gave me meaningful theories and practices about government's role and intervention into firms. I admire his marvelous knowledge and his understanding Vietnamese SOEs, which has contributed tremendously to my paper.

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Finally, I wish to thank my beloved family members, especially my husband and my baby, for their sharing and wholehearted support during the time I conducted this paper.

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LIST OF ABBREVIATIONS

DES	Debt-Equity Swap
DTAC	Debt and Asset Trading Corporation
GI	Government Inspectorate
GSO	General Statistics Office of Vietnam
IPO	Initial Public Offering
MOF	Vietnamese Ministry of Finance
MOT	Vietnamese Ministry of Transportation
SC	State Corporation
SCIC	State Capital Investment Corporation
SEG	State Economic Group
SOE	State-Owned Enterprise
VINALINES	Vietnam National Shipping Lines
VINASHIN	Vietnam Ship-building Industry Group

CHAPTER I: INTRODUCTION

After the "Doimoi" Renovation (1986), the purpose of which was to transform the centrally-planned economy into a market-driven one, Vietnamese government established a number of state-owned enterprises (SOEs), who controlled all key areas of the economy including electricity, construction, agricultural products, coal and textile. Big-size SOEs were initially formed as state corporations (SCs). They were later transferred into parent company-subsidiary company relationship in 2001 in a pilot program. Some of SCs were turned into state economic groups (SEGs) in 2005. Until 2011, Vietnam had 12 SEGs and 96 SCs, all of which were based on parent company-subsidiary company relationship.

As SOEs control almost all major sectors of Vietnam's economy, the government has made efforts to improve their performance and efficiency. Most recent and noticeable facilitation toward SOEs includes further adjustments in legal frameworks of business ownership and financial support. However, many firms who have been supported by the government have shown poor performance and low efficiency. The government has been wondering why SOEs have not been successful and utilized its favorable conditions given by the government to improve their performance and efficiency.

In order to answer the above question, the author formed the main hypothesis that the financial support and intervention from the government cause the double moral hazard in SOEs, which is the main cause of SOEs' inefficiency. First, the financial support is an implicit insurance for firms' careless investment. Second, worrying that the government's backing could lead to moral hazard, Vietnamese government has tried to direct SOEs with top-down intervention and regulations, believing that these actions will limit the risky behavior. The government has supposed that the combination of financial backing and their direction will help SOEs perform well. However, instead of preventing SOEs from making risky decision, heavy intervention makes SOEs rely on the government's direction passively. They believe that the government will be responsible for what they order firms to do. Therefore, the government's intervention doubles the moral hazard in SOEs. This can be explained shortly in the following proposition (1) as the main hypothesis of the paper:

Financial Backing + Top-down Intervention = Careless Decision + Passive Management

The author considers two alternative hypotheses based on two viewpoints.

First is that the role of the leadership is decisive. Experts studying leadership could argue that leadership, especially the CEO could change the situation in Vietnam's SOEs. Certainly, without other factors, only capable leadership can affect firm's efficiency positively. The author put the factor of capable leadership to the situation of SOEs in Vietnam to see if it with the government's intervention, capable leadership could still control the situation and make the firm efficient. Based on this viewpoint, the author set up the following proposition (2) as an alternative hypothesis:

Capable Leadership + Financial Backing + Top- down Intervention = Careful Decision + Active Management

This viewpoint was persuasively presented by Jonathan M. Karpoff, University of Washington and Emory University in 2001 in the paper "Public versus Private Initiative in Arctic Exploration: The Effects of Incentives and Organizational Structure". Karpoff looked at a number of noticeable cases of public and private Arctic expeditions. He used a huge set of statistical data and recognized that private ones got significant achievement without serious losses while public ones faced the opposite circumstances. His main discovery was that public expeditions' poor performance is mostly due to the leadership of the crews. The public expedition's leadership had few incentives to pursue expeditions, slow adaptability to new information and led unsuitably-structured organization.

However, the case of VINASHIN has shown that the leadership (both before and after the restructuring program) has got very few chances to prove whether they are capable. The government has directed them to practice its policies. SOEs' leadership became policy practitioners. They have few incentives to maximize their ability to make firms efficient.

Experts could also argue that competition must be a factor affecting a firm's efficiency. In 1993, a group of authors, Pinto, Brian; Merek Belka, and Stefan Krajewski in their paper "Transforming state enterprises in Poland: macroeconomic evidence on adjustment" claimed that in a free market with strong competition, SOEs could be as efficient as private firms. However, the authors also discussed that this optimistic picture happened if there were managerial incentives, elimination of easy loans. Comparing to the main hypothesis, these conditions already mean little financial backing and government's intervention. In Vietnam, all the major industries are now under SOEs' control. The competition is actually among SOEs. The government has intervened in SOEs' activities as if they have owned all SOEs. The government could move some part of one SOE to another one to reduce the burden of debt for the former one. This happened in the case of VINASHIN. Therefore, the factor "competition" is already weakened by the factor "top-down intervention". In particular, in the case of VINASHIN, the government moved some parts of VINASHIN to another SEG, Vietnam National Shipping Lines (VINALINES). Even if there were more than two ship-building SOEs to form competition among them, it would be difficult to have real competition when the government intervened into their activities deeply. Obviously, such intervention limited competition among SOEs. This argument is actually supportive to the main hypothesis. Therefore, the author will work only on the propositions (1) and (2).

Vietnam Ship-building Industry Group (VINASHIN) has been supported by Vietnamese government with easy access to financial recourses and favorable regulations since its establishment in 2006. However, contradict to the government's expectation, VINASHIN fell into huge debt. It was in insolvency in 2009 and had to go through a restructuring program. After the restructuring program, the government has tried to rescue this economic group with more loans and support in 2011 and 2012. Besides, the government has assigned the Ministry of Transportation (MOT) to supervise VINASHIN's organization and investment. A large part of the debt has been transferred to VINALINES[1] who is another SEG. The case of VINASHIN has become the most noticeable case of SOEs who received the government's tremendous support but conducted poor performance.

Studying the case of VINASHIN both before and after its insolvency, the thesis will describe the government's intervention and support to VINASHIN and the economic group's inducing unnecessarily high level of risk-taking behavior. Analyzing favorable policies given to VINASHIN from its establishment to its insolvency and later to its restructuring program, the thesis will show a pattern of government's support and VINASHIN's dependence on this support to gain increasingly big loans. The thesis concludes that the case of VINASHIN is consistent with the hypothesis that the government's backing and intervention could lead to careless decision and passive management. Furthermore, the results will provide implied lessons for improving SOEs' performance and efficiency.

[1] Unable to cover the debts of VINASHIN, VINALINES has even been reported to make a loss of 1,686 billion VND (80.84 million $US) by the Government Inspect in May 2012. This paper will not look at details of VINALINES case and just focuses on the case of VINASHIN.

The thesis includes five chapters. Chapter II is a literature review which looks at a number of papers discussing how the government's intervention, especially financial support lead to firms' inducing high level of risk-taking behavior. Several examples happened in United States and Korea. It also summarizes quite a few remarkable studies about Vietnamese government's SOEs, especially during its equitization process. This process indicated that Vietnamese government had been struggling between improving SOEs and maintaining its dominant role. Chapter III explains the main hypothesis using Vietnamese government's actions toward SOEs. The chapter describes how the government has intervened in firms' operation and firms' heavy dependence and poor performance. Chapter IV is about the specific case of VINASHIN. It analyzes the data from the case of VINASHIN with the particular favorable policies and direction from the government and VINASHIN's risky behavior, which led to its insolvency. Then, the data analyzed show that the case of VINASHIN is consistent with the main hypothesis and rejects the alternative one. Chapter V includes key conclusions and implications.

CHAPTER II: (LITERATURE REVIEW)

Government's backing and moral hazard in big businesses

2.1. Government's intervention and firms' risk-taking behavior

"Moral hazard" is a basic term that was originally used in insurance industry. It meant that people with insurance might be more careless when they were insured since they believed that the insurance companies would finally pay the losses caused by their carelessness. Consequently, they induced more risk-taking behavior than they should. The term has later been used in finance, banking, and other areas of economics including government's backing to big firms no matter if firms are private or state-owned.

The term is often linked to "too-big-to-fail" financial institutions, which are thought by a number of governments to cause systematic fall to other institutions related to them if they fall. Therefore, these governments often protect big institutions with continuous subsidies. Learning that they are well protected and the governments will always pay for their risk and failure, firms often take more risk in lending and investment.

The term can be understood the same way when a government supports big firms in other industries, especially those are considered strategic industries of the country. Also believing that the fall of big firms may affect the employment status, the institutions related to them or even the whole economy, the government also considers them "too-big-to-fail" firms and tries to rescue them whenever they face to bankruptcy.

That a government is trying to intervene into firms' operation can be linked to various theories and viewpoints on free market economy, planned economy and public good. However, this thesis paper narrows down to the moral hazard happening in firms who are insured by the government.

There have been a number of studies about institutions and firms' inducing high level of risk-taking behavior due to the government's support. A number of authors believe that firms who are supported by the government could take more risk and therefore, have poorer performance and lower efficiency. However, some others claim that worse outcome is uncertain. This supports the facts that many governments, including Vietnamese government still choose establishing and supporting SOEs the key to boost the economy.

One of the examples is the case of U.S. government in 2006 during the U.S. subprime mortgage crisis. The federal takeover of Fannie Mae and Freddie Mac showed the serious weakness of the government-sponsored enterprise (GSE) business model and its unreasonable combination of government mission and private ownership. Among many experts who studied this case was Peter J. Wallison, a resident fellow at American Enterprise Institute for Public Policy (AEI). Using the theory of market discipline, Wallison looked at the case of Fannie Mae and Freddie Mac to demonstrate how the government's backing led to moral hazard. "Fannie and Freddie's debt obligations - not just some limited amount corresponding to a bank's deposits – [were] seen by U.S. and foreign investors as nearly risk-free, and therefore [were] not subject to market discipline. In effect, they [were] given a free pass to take risk."[2] The absence of market discipline he pointed out was more obvious when "they were not required to take the steps that all other companies must take to maintain their good credit standing, and so they did not take these steps."[3] He also criticized that "there [was] no reason why Fannie and Freddie should be permitted to buy and hold large portfolios of mortgages...Fannie and Freddie, in addition to their shareholders and managements, [would] profit from holding these portfolios, but if the risk they take [caused] them to suffer serious

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[2] Peter J. Wallison, Moral Hazard on Steroids: The OFHEO Report Shows that Regulation Cannot Protect U.S. Taxpayers, AEI Outlook Series, *Website of American Enterprise Institute For Public Policy Research*, June 23, 2006, http://www.aei.org/outlook/24591
[3] Ibid

losses, the taxpayers [would] pick up the tab."[4] With this conclusion, he insisted that the only way to reduce the risk was to reduce risk activities. Consequently, regulations should limit the risk activities that firms could take. However, this recommendation could not truly solve the problem. Firms who are supported will always have incentives to induce risky behavior. Regulations may limit their activities in some areas but not all. They will try to take other risk activities in unregulated areas.

Although a number of authors have claimed that the government's backing could lead to moral hazard, and therefore lead to the supported firms' inefficiency, there are still debates on whether risky behavior leads to firms' low performance. In 2009, Baird Webel, a specialist in financial economics at U.S. Congressional Research Service (CRS) studied the impact of enduring government assistance for the American International Group (AIG). The author looked carefully into the evidences of the government's support to AIG such as "$85 billion loan from the Fed… on relatively onerous terms with a high interest rate,…a handover of 79.9% of the equity in AIG to the government, … up to $70 billion in capital injections through preferred share purchases by the Treasury… "[5] Looking at the subsidies and AIG's performance, he concluded that "[d]espite access to up to more than $190 billion in assistance from the federal government, the outlook for AIG [appeared] very uncertain… [and] the long-term effect of the government involvement with AIG [was] unclear."[6] This judgment was from the fact that potential customers of AIG valued the government's support differently. "[Some might] conclude that, because of the government backing, AIG [was] a safe and reliable company to purchase insurance from… [Others did] not want to rely on a

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[4] Ibid

[5] Baird Webel, Specialist in Financial Economics, U.S. Congressional Research Service (CRS), "Ongoing Government Assistance for American International Group (AIG)" (document prepared for Members and Committees of Congress, 2009), http://www.fas.org/sgp/crs/misc/R40438.pdf, 1.

[6] Baird Webel (2009), 11.

business that [depended] on a government support to continue operating."[7] Within this logic, it could be uncertain for big firms in other industries who are supported by the government to have poor performance or not. Firms who are well guaranteed by the government may have more consumers and receive more contracts as people believe it will be eternally strong under the government's protection. However, the author only looked at the short-term effect of the government's support. After a long time, if a firm faces to insolvency for a number of times and the government continues its support, hardly can any customer believe in the firm's strength.

Another famous case is Korean government's support to chaebol groups[8]. Many authors have been interested in chaebol establishment and expansion. Among them was Kim Ky Won with his paper "Chaebol Restructuring and Family Business in Korea" in 2004. The author pointed out that from the earlier establishment since Korea's independence from Japan, chaebol started with a number of advantages given by the new government. In order to rebuild the country, Korea had to redistribute the properties left by the colonists and "[re-establish] the external trade and foreign exchange regime…"[9] In this period, "formerly Japanese-owned industrial properties…[were sold] far below the market value ..."[10] Those businesspersons who got these conditions were the founders of chaebol[11]. Second, according to the author, after the war, Korea had to import a big amount of consumer goods. As the import trade market played a significant role in the country economic development, chaebol

[7] Ibid.

[8] This thesis paper narrows down to Vietnam's SOEs and does not compare Korean chaebol and Vietnam SOEs. Chaebol have been recognized by many people as Korean's pride and surely gained particular success. The paper only looked at Chaebol from the aspect that the government used the firms as their policy instruments that led to moral hazard.

[9] Kim Ky Won, "Chaebol Restructuring and Family Business in Korea", presented at the IDE International Workshop on Family Business in the Developing Countries, January, 2004, 3.

[10] Ibid.

[11] While some authors consider early chaebol government's favored group, most others believe they selected based on capability.

gained enormous opportunities. Again, the government gave outstanding advantages to chaebol groups. Third, when the government promoted export, "the chaebol were able to gain access to operating money at low interest rates from Korean banks,…[and] massive introduction of foreign loans,…explicit repayment guarantees to foreign financial institutions on loans extended to the chaebol."[12] With all these advantages, chaebol had risk partnership with Korean government. The government monitored the loans and issued the loans to chaebol not only when chaebol needed financial resource but also when the government wanted them to realize its industrial policies. The government's support to chaebol groups is more noticeable in the investment boom in the late 1960s. When "firms could not meet their foreign debt obligations, the government held the incumbent owners accountable by taking over managerial control of their companies."[13] The government's backing to firms in this case is like a full insurance with cheap premium. Chaebol groups would be saved from any bad consequences and were given highest incentives to take highest risk.

The author emphasized that Korean chaebol groups received most support from the government when the country directed toward heavy and chemical industries in 1970s. "Along with the Emergency Decree of 1972, which placed an immediate moratorium on the payment of all corporate debt to the curb lenders, this drive transformed the government-business risk partnership in favor of the chaebol."[14] Moreover, in order to support chaebol, the government had to trade off the development of small and medium firms in light manufacturing industries. At this time, chaebol's expansion was not based on competitiveness but the power of the government. Obviously, the author described how chaebol were established following the government's policies in trade promotion and industry development. Although chaebol groups were private businesses, they were actually

[12] Kim Ky Won (2004), 3.
[13] Kim Ky Won (2004), 4.
[14] Ibid.

used as industrial policy instruments. The Korean government's heavy intervention happened frequently from the early birth of chaebol groups until their peak of development.

Due to the government's backing, the author also claimed that chaebol faced to serious problems although a number of chaebol groups gained huge benefits and grew fast in the early stage. In 1970s, "the chaebol grew to control businesses across most of the important industries, including manufacturing, distribution, construction, and so on. The ten largest chaebol increased their share of [gross national product] (GNP) from 4.7% (1974) to 9.7% (1979)... The number of affiliates of the 30 largest chaebol rose from 126 in 1970 to 429 in 1979, with the average number of affiliates changing from 4.2 to 14.3 during the same period..." [15] However, when the government support was abused, the market became uncompetitive. Besides, big chaebol groups used their privilege carelessly. As they controlled all major industries and resources of the country, their losses meant huge damage to the economy. "Korea found itself in a severe economic crisis in 1979 and the chaebol sector was a major culprit. Its expansion into uncompetitive businesses endangered macroeconomic growth and stability."[16]

2.2. The government's intervention and support and moral hazard in SOEs in Vietnam

In Vietnam, SOEs have been studied by international and domestic experts since its establishment. SOEs' performance has been increasingly noticed since their equitization. It is obvious that Vietnamese government "recognized the inefficiency of SOE sector but attempted to restructure and equitize SOEs rather than privatizing them"[17]. This is why many papers have studied the equitization process of SOEs to identify what the government has done and what should be done to improve SOEs' efficiency. Various studies have worked on

[15] Kim Ky Won (2004), 5.

[16] Ibid.

[17] Central Institute for Economic Management (CIEM), "Vietnam Economy" SOE reform and Market Structure", a presentation at APEC Submit 2011.

the efficiency of SOEs' equitization process and provided different outcomes. Some studies have claimed that a number of equitized SOEs "[have] been able to mobilize investment capital to upgrade equipment and technology, become more efficient …and adapt better to the market mechanism."[18] Others believe that "Vietnamese government faced with many difficulties in the equitization process… [and] the changes in legal frameworks acknowledged the Government's efforts…to reduce the loss [of state property]…"[19] However, most of the studies looked at the final outcomes, economic performance without linking those outcomes to the original reason of the government's backing and intervention while it is the core cause of the inefficiency of equitization process.

Early after two first periods of the equitization process, the Pilot Equitization (1991-1997) and the Accelerated Equitization (1996-2001), a joint survey led by Tran Tien Cuong, PhD., Director, Central Institute for Economic Management (CIEM), Ministry of Planning and Investment (MPI) in 2002 named "Vietnam's Equitized Enterprises: An ex-post Study of Performance, Problems and Implications for Policy" produced a comprehensive evaluation of the equitized firms. The study randomly surveyed a large sample of 877 enterprises in almost all economic sectors and provinces of Vietnam. The questionnaire was carefully constructed to obtain both quantitative measures of performance trends of the enterprises and qualitative assessment through senior enterprise managers' opinions. The quantitative questions aimed at collecting important performance indicators including profit, exports, labor productivity, assets, total labor cost, average wage, number of workers, value-added and sales while the qualitative ones explored the role of the firms' directors during the decision-making process. "With ninety percent of respondents saying that financial performance was rated "better" or

[18]Tran Ngoc Phuong, Standing Vice Chairman, "Ho Chi Minh City's Enterprise Reform and Management Board. Reform of State Owned Enterprises in the Context of Vietnam's WTO Accession" (working paper, WBI-Training Program with World Bank, 2005), 9-10.

[19] Vo Tri Thanh, PhD., Vice President, CIEM, MPI, "Lessons for Vietnamese government in Equitization: Evidences from IPO's" (working paper, 2011).

"much better"…"[20], the study concluded that there was "a strongly positive result for equitization" and the role of the board of directors has become more important in the decision-making process of the enterprises. Undoubtedly, the huge data source and detailed survey statistics produced an overall picture of the equitized firms. However, as the questionnaire asked for opinions of managers to evaluate the firms' performance as "better" or "worse," a number of results turned out to be personal judgments. Moreover, the paper did not realize that the role of the board of directors was actually decided by the government's level of intervention into the firms. Those who were under government's heavy intervention and backing could behave differently from those who were not.

Another study which also compared the enterprises' performance before and after equitization was "Equitization and Firm Performance: The Case of Vietnam," a study in the East Asian Development Network (EADN) grant project in 2007, ten years after the start of the third period of equitization, the Related Transformations (1997-Present). It was conducted by a group of independent experts: Truong Dong Loc (Team Leader), Nguyen Huu Dang and Nguyen Van Ngan in Vietnam. Applying the regression testing methodology by Megginson, Nash and Randenborgh (1994) and collecting the data of 147 equitized firms and

[20] Tran Tien Cuong, PhD., Central Institute for Economic Management (CIEM), "Vietnam's Equitized Enterprises: An ex-post Study of Performance, Problems and Implications for Policy", a joint survey by CIEM, MPI and World Bank in 2002, 29. (According to the acknowledgement of the paper, it was conducted by a team of researchers and experts: "This report was prepared under the auspices of the Central Institute for Economic Management (CIEM), an organ of the Ministry of Planning and Investment (MPI). The Study Team was headed by PhD Tran Tien Cuong, Director of the CIEM's Business Management Department. The survey was executed by Investment and Business Consultants, Inc (IBCI), an affiliate of the Vietnamese Chamber of Commerce and Industry (VCCI), under the guidance of Nguyen Gia Hao. Key personnel at CIEM were Bui Van Dung, Nguyen Kim Anh, Pham Duc Trung, Nguyen Thi Lam Ha, Nguyen Thi Luyen, and Trinh Duc Chieu. Leroy Jones and Raymond Mallon served as international consultants. Statistical analysis was done by domestic consultants Hoang Thanh Huong and Pham Anh Tuyet. The International Bank for Reconstruction and Development (IBRD or World Bank) provided financial support and inputs from Kazi Matin, Daniel Musson and Minh Pham Duc."), http://siteresources.worldbank.org/INTVIETNAMINVIETNAMESE/Resources/other_reports_post_equitization.pdf

92 SOEs, the study focused on performance measures including profitability, operating efficiency, output (real sales), leverage, employment and employee income. The survey was designed with objective criteria and consisted of one questionnaire focusing on income and debt of the firms and another one evaluating ownership structure, the board of directors and personal management based on statistics and numbers. This study's advancement was the comparison of results from the statistical test for two groups: Control Group (SOEs) and Treatment Group (equitized firms) which controlled a number of other dependent variables. Different from previous papers which focused on the reasons that improved performance, the study identified both negative and positive impacts of a number of determinants on firms' performance including size of firms, ownership and corporate governance, state ownership, chairperson of the board of directors and the stock-market. Obviously, the innovative comparison and regression tests brought a critical view into the impacts of various factors on firms' performance. However, the study produced over-optimistic outcomes as it did not identify the government's support in each period of time.

Among the most recent studies was "Governance of Economic Groups in Vietnam: A Proposal for Reform," which was conducted in January 2011 by Professor Il Chong Nam, KDI School for Public Policy and Management, Republic of Korea and Le Manh Hung, Deputy Director General, Agency for Enterprise Development, MPI. The Korean author has understood fully and deeply Vietnam's SOEs including SOEs' context and the reasons for SOEs' poor performance. The study frankly criticized the management structure of SOEs and strongly recommended a set of critical measures in equitization process to improve Vietnam's overall situation. Studying carefully the performance of SOEs and the current legal frameworks, the authors came to a creative and clear policy proposal including "unbundling of governance of [SOEs] from other government functions… running [SOEs] as commercial, profit-oriented enterprises …, [clear] appointment, evaluation, remuneration of executives and board members, and [improving] transparency in accounting and finance." The paper has found out that "there is a wide variation in the growth rate, profitability, and debt/equity ratios. While most State Economic Groups (SEGs) show reasonably high profitability and debt/equity ratios, some SEGs show very low profitability. Further, some SEGs or their subsidiaries have extremely high debt/equity ratios with very low profitability, suggesting that the risk of insolvency can be high for those firms."[21] The paper has concluded that the Decree on Pilot Establishment, Organization, Operation and Management of the State Economic Groups in November 2009 "specifies building of competitive business organizations as one of the main objectives of governance of SEGs [while] it also allows the government to use SEGs as policy instruments. As a result, the line ministries are still playing a crucial role in the governance of SEGs. The Decree also contains a number of elements that are not compatible with the efficiency of an SEG, subsidiary of an SEG, or elements that are not consistent with effective enforcement of the competition policy or regulation of public utilities."[22] By this way, the author has identified the deepest reasons why a number of EGs in Vietnam have been performing inefficiently. He also emphasized that "[t]he government needs to accept the principle that for Vietnam to prosper economically it is necessary to clearly separate the roles of the government and the roles of the corporate sector. Commercial enterprises need to be run by profit seeking management."[23] This thesis agrees with the author on that Vietnamese government wishes to use SEGs as policy instruments and looks into the particular case of VINASHIN to demonstrate the particular consequence of the government's intervention as causing moral hazards.

[21] Il Chong Nam (2011), Professor of KDI School for Public Policy and Management, "Governance of Economic Groups in Vietnam: A Proposal for Reform", Knowledge Sharing Program (KSP)'s final report, 2-3.

[22] Il Chong Nam (2011), 2-3.

[23] Il Chong Nam (2011), 35.

From above analyses, it is obvious that a number of previous studies have constructed a huge data set of SOEs, especially in the equitization process in Vietnam. However, many of them did not fully study the core reason of firms' unreasonable investment, which mainly causes the poor performance and the inefficiency of SOEs. Therefore, a case study like this thesis paper is needed to describe how the government's backing could lead to firms' inducing high level of risk- taking behavior and then, their shutdown. The thesis paper will draw lessons from the case study to recommend practical ways to improve its situation. These lessons could be useful to similar cases of SOEs in Vietnam.

CHAPTER III: VIETNAMESE GOVERNMENTS' FINANCIAL SUPPORT AND INTERVENTION IN BIG FIRMS AND THEIR INEFFICIENT PERFORMANCE

This chapter explains the main hypothesis, proposition (1), using the government's intervention in SOEs in Vietnam and their efficient performance. This is consistent with the hypothesis that moral hazard happens when the government bails out firms.

Financial Backing + Top-down Intervention = Careless Decision + Passive Management

The government's financial backing to SOEs is obvious as SOEs are established under the government decisions. Moreover, SOEs are given capital to realize the government's policies. The government's intervention into all SOEs in general is mostly shown by its legal regulations applying to SOEs. As the author looks at SOEs in general in this chapter, their careless decision and passive management are indirectly shown by their poor performance and low efficiency.

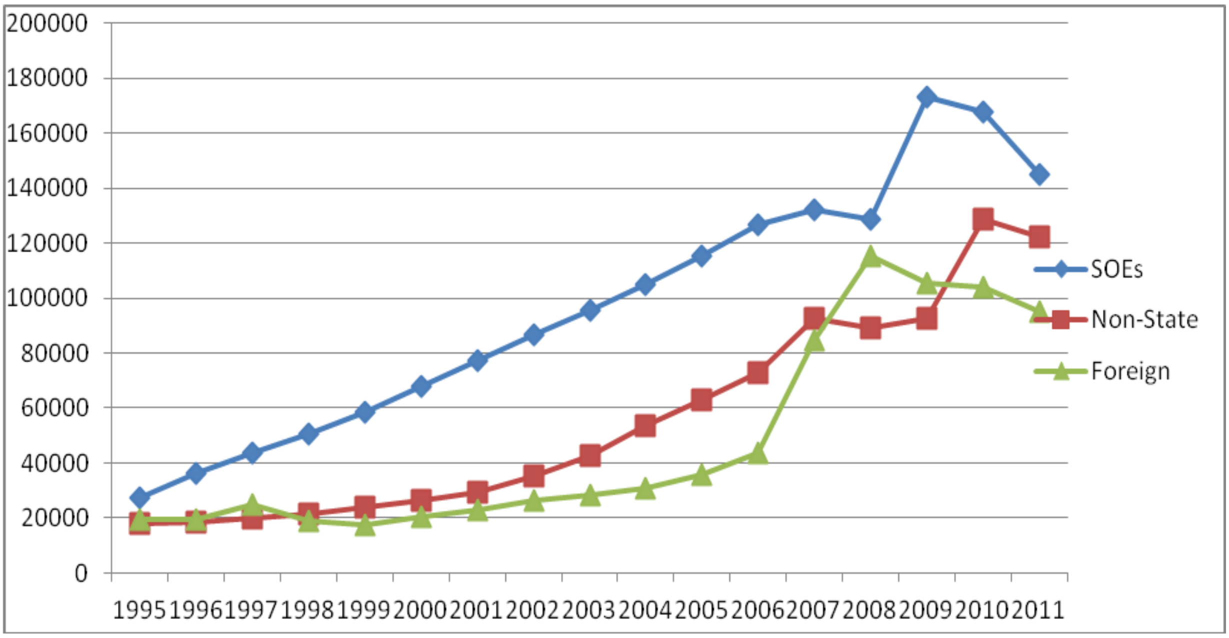
3.1. Vietnamese government's financial support to SOEs

As SOEs have been always considered the key of the nation's economy, the government has put huge investment into SOEs.

From early birth as SCs, SOEs were established using State budget. When transforming SCs to SEGs, the government used more investment to turn them into large conglomerates. Comparing to non-state sector and foreign-invested sector, SOEs have always received biggest investment. According to the General Statistics Office of Vietnam (GSO), the investment into SOEs has a firmly increasing trend from 1995 to 2010 (based on fixed price in 1994) as shown in chart 1. Moreover, its ratio over the total investment is always from 40% to 60% in the last 17 years[24] as shown in chart 2.

Chart 1: Investment among sectors (SOEs, Non-SOEs and Foreing-Invested sector) in Vietnam

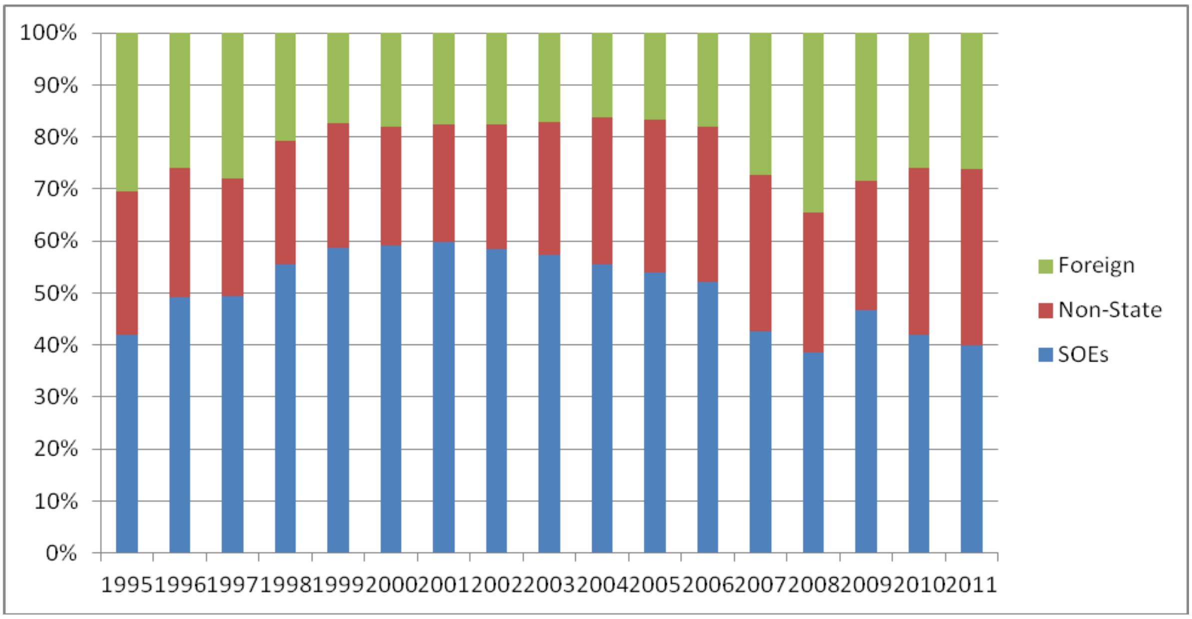
Source: General Statistics Office (GSO) of Vietnam, http://www.gso.gov.vn/default.aspx?tabid=392&idmid=3&ItemID=11380



[24] The data of the year 2011 is preliminary data

Chart 2: Investment among sectors (SOEs, Non-SOEs and Foreing-Invested sector) in Vietnam in percentage

Source: General Statistics Office of Vietnam, http://www.gso.gov.vn/default.aspx?tabid=392&idmid=3&ItemID=11380



Next, SOEs have got easy access to all sources of loans as banks have relied on the government's suport. According to the publication of the auditing results of SCs and SEGs in July 2012, 11 over 21 audited SCs and SEGs have been reported to operate using loans as the main source of capital. The list of SOEs who rank highest in the list of high debt/equity ratio includes Truong Son Construction SC with that ratio of 9.19 (times), Infrastructure Construction and Development SC with that ratio of 4.79,Vietnam Housing and Urban Development SEG (HUD) with that ratio of 4.01, EVN with that ratio of 3.83, and VINALINES with that ratio of 3.21[25]. Easy loans have led to the huge bad debt of banks. According to Dr. Deepak Mishra, an expert in World Bank, Vietnamese SOEs' debt accounts

[25] The data about SOEs with high debt/equity ratio is reorganized from the article by Thuy Duong, "*Publication of auditing results of SCs and SEGs*", Vietnam Customs website, 18 July 2012, www.baohaiquan.vn/pages/cong-bo-ket-qua-kiem-toan-nha-nuoc-cua-nam-2011-cac-tap-doan.aspx, the original article is in Vietnamese.

for 60% of all banks and financial institutions' credit and 70% of the total bad debt of all the banks in the country[26].

Another problem is about SOEs' land ownership. While private firms in the country have had to hire or buy land at high price, SOEs own a large total area of land. Although SOEs also have to pay a rental fee, the fee is quite low which is 2,316 VND/m2 (1.09 $US/m2). Some SOEs even pay lower fee, from 800 to 1000 VND/m2 (0.38 to 0.47 $US/m2). This special advantage makes a lot of SOEs try to own as much land as possible and sell the land when they need more investment capital. A number of SOEs own land sites at valuable locations but abandon the land sites for a long time which is really a waste of resources. One example is Southern Food State Corporation (VINAFOOD 2). According to the Public Assets Management Agency under Ministry of Finance (MOF), this SC was established in the centrally-planned economic period. It has been allowed to own 351[27] sites in Ho Chi Minh city to construct food retail distribution network over the city. When the economy transferred to market economy, this SC have still kept these sites to construct housing buildings for its staff and for rent.

3.2. Vietnamese government's remained dominant intervention in SOEs

Vietnamese government's intervention in SOEs is clearly shown by a number of actions from its establishing SOEs in the early time to its regulations applied to SOEs in the present time, including:

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[26] The data about Vietnamese SOEs' debt is reorganized from the article by Tran Minh Tinh, "SOEs' bad debt: clear objectives but unclear roadmap", *VINA Corp*, March 13 2012, vinacorp.vn/news/xu-ly-no-xau-doanh-nghiep-nha-nuoc-muc-tieu-da-ro-lo-trinh-thi-chua/công trình-505641, the original article is in Vietnamese.

[27] The data about VINAFOOD 2 is reorganized from the article "SOEs tries to maintain valuable land sites which create losses for the government", *Education Newspapers website*, March 24 2012, giaoduc.net.vn/NTD-thong-thai/Doanh-nghiep-nha-nuoc-chiem-giu-dat-vang-gay-lang-phi-lon/132902.gd, the original article is in Vietnamese.

- Establishing and restructuring SOEs as policy tools;

- Intervening heavily into the valuation process;

- Issuing few preferential policies for creditors in the debt-equity swap (DES);

- Issuing few incentives for investors to become shareholders of SOEs;

- Applying increasingly strict financial supervision to SOEs.

A summary of the legal documents studied in this chapter is presented in the following table:

Table 1: Legal documents related to SOEs

No.	**Legal Documents' Names**	**Main contents**
1.	Financial Supervision Regulation	Putting all SOEs and the enterprises having State equity under strict financial supervision
2.	Government's Decree No. 153/2004/ND-CP dated 09 August 2004	Transferring SCs into parent company-subsidiary company form
3.	Government's Decree No. 187 dated 16 November 2004	Regulating that firms must maintain some parts of state equity in order to be equitized
4.	Circular No. 126/2004/TT-BTC dated 24 December 2004	Regulating that Debt-Equity Swap process would have to follow the IPO regulations with the price identified in the public auction
5.	Prime Minister's Decision No. 14/2011/QĐ-TTg dated 14 March 2011	Setting the criteria and categories of the SOEs which are 100% owned by the state

6.	Government's Decree 59/2011/ND-CP dated 18 July 2011 (replacing the Decree 109/2007/ND-CP)	Transforming the SOEs who are owned 100% by the state into equitized firms
7.	Prime Minister's Decisions No. 90-TTg and No. 91-TTg dated 07 April 1994	Establishing SCs 90 and SCs 91

3.2.1. Establishing and restructuring SOEs as policy tools

Since 1980s, Vietnamese government has made efforts to establish SOEs as industrial development tools. After the "Doimoi" Renovation (1986), the purpose of which was to transform the centrally-planned economy into a market-driven one, Vietnamese government established a number of SOEs that controlled all key areas of the economy including electricity, construction, agricultural products, coal and textile. Big-size SOEs were initially formed as SCs according to the two Prime Minister's Decisions No. 90-TTg and No. 91-TTg dated 07 April 1994. SCs were named SCs 90 and SCs 91 following these decisions.

According to the above decisions, SCs 90 must include at least five subsidiaries which operated in the fields of technology, finance, investment program, service, consumers, information and training. SCs 90 must have the size of at least VND 500 billion ($US 25 million). One of the most important features was that line ministries and People's Committees were delegated by the government to establish SCs 90. This made SCs administrative agencies better than firms. After six years, 76 SCs 90 were established including 12 SCs in industrial area, 14 in agricultural product area, 12 in transportation, 11 in construction, three in aquatic product, five in banking, two in medical care, one in post and telecommunication and one in culture. There were nine SCs 90 established by provincial People's Committees.

On the other hand, when the government established SC 91s, they intended to use them as the pilot forms to establish State Economic Groups (SEGs). However, none of them were transformed in to SEGs until 2005. The management in SCs 91 is not much different from that of SCs 90 as they were set up under strict direction of the government. All SCs 91 must be established under the government's decisions. Furthermore, all the members of the board of directors of SCs 91 were assigned by the Prime Minister. Again, the way SCs 91 and their board of directors were established is similar to that of administrative agencies. In details, SCs 91 must have at least seven subsidiaries and the minimum size must be VND 1000 billion ($US 50 million). While SCs 90 focused on one area, SCs 91 could invest in a number of areas but still had to maintain one major field.

The government started to transfer SCs into parent company-subsidiary company form (but maintain their names as SCs) in 2001 in a pilot program which was later regulated by the Government's Decree No. 153/2004/ND-CP dated 09 August 2004. At this moment, the government wished to turn administration mechanism in SCs into investment mechanism. With this effort, the government intended to make SOEs more similar to making-profit firms. In 2005, the Prime Minister established first eight State Economic Groups (SEGs) [28] which were transformed from the SCs of important areas. In total, 12 SCs 91 were transformed into SEGs. Until 2011, Vietnam had 12 SEGs[29] and 96 SCs, all of which were based on parent

[28] They are Electricity Group (EVN), Vietnam Oil and Gas Group (Petro Vietnam or PVN), Vietnam National Coal and Mineral Industries Group (VINACOMIN), Vietnam Post and Telecommunications Group (VNPT), Vietnam Shipbuilding Industrial Group (VINASHIN), Vietnam National Textile Garment Group (VINATEX), Vietnam Rubber Group (VRG) and Vietnam Insurance Group (BaoViet). From 2006 to 2011, four more SEGs have been established.

[29] However, until now, the 12 SEGs which controlled all important industries of Vietnam have not been clearly recognized as any legal entity under the law. According to the

company-subsidiary company relationship. However, as the government could not give up its power and dominant role in SOEs, SEGs enlarged the size of SCs while the management mechanism was not much changed.

During the last two decades, Vietnamese government has been seeking ways to restructure SOEs to improve their performance and efficiency. When one SOE is not efficient, the government can apply one of the following solutions: equitization (changing the SOEs into joint stock companies), selling one whole SOE to another organization, merging the SOE or a part of it to another one, announcing bankruptcy and dissolution, transferring the SOE to limited liability company, transferring the SOE to an income-generating administration agency, moving the SOE to another administrative agency and transferring the SOE into parent company-subsidiary company form. A summary of all SOEs restructured can be presented in table 2:

Table 2: The number of restructured SOEs from 2002 to 2007

Source: the Enterprise Development Agency, Ministry of Planning and Investment (MPI)

Restructuring methods	Number of SOEs restructured
Equitization (totally or partially)	3,756
Selling one whole SOE to another organization	373
Merging the SOE or a part of it to another one	504
Announcing bankruptcy and dissolution	260
Transferring the SOE to single-member limited liability	282

Enterprise Law 2005, SOEs are the enterprises, more than 50% of the charter capital of which is owned by the State. Since 1st July 2010, all the SOEs which were 100% owned by the State, including the parent companies of SEGs, have been transformed to either limited liability companies or joint stock companies regulated by the Enterprise Law 2005.

company	
Transferring the SOE to an income-generating administration agency	111
Moving the SOE to another management agency	77
Transferring the SOE into parent company-subsidiary company form	108
Total	**5,474**

In table 2, from 2002 to 2007, there were more than 5,000 SOEs restructured, more than 3,000 of which were equitized. The number of equitized firms accounted for 55% of the SOEs which were restructured from 2001 to 2010. However, from 2011 to the first half 2012, the equitization process has been slow down due to complicated administrative procedure. Although the government has been trying to give more freedom and independence to SOEs by equitizing them, the government still controls the equitization process tightly.

In details, the definition of equitization is clarified with the following criteria: "the equitized enterprise is registered as a joint stock company, operating under the Enterprise Law applicable to private enterprises…; ownership is diffuse…; competitive bidding is not used; workers and managers become majority owners…; the state often retains some share, but seldom is the majority shareholder…; and third parties almost always take some share but seldom a majority stake."[30] The overall process of equitization process can be summarized in the following table:

[30] Tran Tien Cuong (2002), 6-12.

Table 3: The equitization process in Vietnam

Source: The table is redrawn based on the source from the Eurocham Vietnam

www.eurochamvn.org/downloads/EquitizationProcessVietnam.ppt

Equitization Plan	**Initial Offering**	**Completion**	**Post-Equitization**
-Establishment of Steering Committee and Assistant team -Documentation: valuation method, legal document, audited financial statements and other related assets' approval -Equitization plan: introduction, labor planning, business and equitization plan, IPO method	-Association with financial institute to IPO -Auction at the company/securities companies/ stock exchange	-Shareholders' meeting -Publicizing information about the newly formed joint-stock company -Hand over from SOE to joint-stock company -Registration and licensing	-Restructuring Management - Audit appointment

Right from the definition of equitization, there is a paradox. The government wishes a number of parties own and be responsible for a firm's operation so that it will be more competitive while the government still desires to control the equitized firm by its role as the major shareholder. This equitization process implied that the government had been being trapped in its efforts. It cannot give up its intervention in SOEs while at the same time it demands SOEs to perform well and boost the economy.

In the last two decades, the equitization process has passed through four stages[31]. However, although the government tried to make several changes in each stage, all the stages of the equitization process have not shown enough incentives to board of the directors as well as the share holders. The government has still supervised and directed SOEs' management as administrative agencies. This ambition of the government has not only slowed down the equitization process but also created double moral hazard as the equitized firms have reasons to depend on the government's support and direction passively.

3.2.2. Intervening into the valuation process

Vietnamese government remained controlling power over SOEs most noticeably in SOEs' valuation process. Although the Government's Decree 59/2011/ND-CP dated 18 July 2011 on "Transforming the SOEs who is owned 100% by the state into an equitized firm" has replaced the Decree 109/2007/ND-CP[32] and amended some important issues to accelerate the equitization process, there are still concerns about the valuation process of SOEs to be equitized. The core reason is that the government has been worried that SOEs will be valued too low which would lead to huge loss of the state assets.

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[31] The first one was the Pilot Equitization (1991-1997) which was based on voluntarism. The SOEs chosen were of small and medium size, high efficiency and operating in the fields the Government did not have to control 100% equity. Moreover, the workers and the managers of the SOEs chosen volunteered to equitize the firm. These were the criteria of the Prime Minister's Decision No. 202/CT dated 08 June 1992 and Directive No. 84/TTg dated 04 Aug.1993. In five years, there were only five SOEs equitized. The second stage was the Expansion of the Pilot one. There were only 25 SOEs equitized in this period. The third is the Accelerated Equitization (1997-2001) with the Government's series of modifications to the process. One of the most noticeable legal documents was the Decree 44/1998/NĐ-CP which gave incentives to the SOEs equitized and their workers. The last one is Continuing the Equitization Process Intensively (2001-Present) with the issue of the Decree 184/2004/ND-CP. Only until this time, the government started to request a transparent auction to put the enterprises on the stock market. This Decree intended to create a more transparent and healthy environment for the equitized SOEs.

[32] According to the new decree, a firm's competitive advantage includes only trade mark value and development potential, not geographical location as stated in the old decree 109/2007/ND-CP.

According to the Article No. 27 of the new decree, the State Auditing Office (SAO) must participate into the valuation process before IPO of the enterprises whose size is above VND 500 billion ($US 25 million) in insurance, banking, telecommunication, airline, coal and valuable minerals mining areas. The maximum period of time for SAO to complete the auditing is 75 working days which is obviously a long time. As most of the firms in Vietnam are of this size, the overall equitization process will be seriously slowed down. This Article also regulates that when the valuation results made by authorized agencies and the (SAO) are different, there should be meetings for parties to come to one final outcome or reports to the Prime Minister before the publication of the firm's value. This regulation has lengthened the valuation process in a number of equitized firms.

Next, according to the Article No. 32 of the new decree, "business advantage" is calculated as a part of the firm's value. However, many equitized firms have met difficulties in identifying how much trademark value and development potential contributes to the firm's value, especially when this issue is quite new to Vietnam.

Until now, the valuation process has not been undertaken by one or a group of independent valuation institutions. The decision makers are still government agencies representing the SOEs' ownership. This makes the valuation process lack transparency and damages the trust of investors.

When the valuation system is still problematic, SOEs meet difficulties in speeding up their IPO.

3.2.3. Issuing few preferential policies for creditors in the debt-equity swap

Recently, the government has been trying to create more solutions for insolvent firms. However, during the practical process, the government still hesitates to give enough incentives for creditors.

Among the most effective solutions is debt-equity swap. This is clearly explained in the recent Government's Decree 59/2011/ND-CP. This new decree is an amendment to the old decree about the insolvent firms. In the old decree, after the firm valuation process, if the present value of the firm is lower than the debt, that firm will have to announce bankruptcy or dissolution. However, the new decree allows the Debt and Asset Trading Corporation (DATC) under MOF and the creditors to establish the restructuring plan together, mostly through DES method. If the restructuring is not feasible, the firm can be later transformed into other forms[33]. Moreover, in the past, according to the Government's Decree No. 187 dated 16 Nov. 2004 and MOF's Circular No. 126/2004/TT-BTC dated 24 Dec. 2004, firms must maintain some parts of the state equity in order to be equitized. However, there were firms which already have negative state equity after an inefficient operation time. Under the pressure of these regulations, firms had to exaggerate their true value to occupy the negative equity. Therefore, after equitization, many firms did not have sufficient financial capacity to operate properly. In case the negative equity was too large which could not be occupied by the exaggerated value, the firms could not be equitized and just waited to be sold or announced to go bankruptcy. Now, in similar cases, DES is considered a double-effect solution for SOEs of poor financial status as it can help creditors, in particular, banks to recover their bad debt as well as equitize the firms which are not efficient.

DATC was actually established in order to realize the above new policy. DATC is considered a policy instrument to manage the financial status of SOEs. The most important role of DATC is to work on firms' debt and improve their financial status, transfer their ownership, seek strategic partners to support in capital, technology and management so that the firms can reorganize their management and improve their performance after ownership transferring. However, since 2010, the process of debt transferring has slowed down. This is

[33] "Other forms" are not yet specified by the government.

because while demanding DTAC to seek solutions for insolvent firms, the government has still tried to intervene into DTAC's operation and working mechanism with insolvent firms tightly. Due to the unreasonable regulations, DTAC has met many difficulties in debt-equity swap (DES) as the followings:

First is the limitation in IPO regulations. According to the Circular No. 126/2004/TT-BTC, DES has to follow the IPO regulations with the price identified in the public auction. The circular regulates that the initial shares structure includes the state shares, the shares with preferential prices for workers, strategic partners and the shares sold in public auction for investors. So the creditors have to participate into the public auction like investors. In case the creditors cannot win the auction, the DES will not happen. Due to this limitation, the creditors are unwilling to remove the debt for the firms as they are afraid that the debt is not guaranteed to be transformed to shares through public auctions.

Second, the creditors receive no preferential policies as the workers and strategic partners do. The Circular No. 126/2004/TT-BTC regulates the mechanism of reducing the shares average price to 40% for workers and 20% for strategic partners, but not for creditors. This gives the creditors no incentives to remove the debt for the firms.

Third, the entire surplus gained from the public auction is regulated to be owned by the state. This affects the financial and operation capacity of the firms after equitization. Therefore, the creditors are worried about the performance of the firms after equitization and hesitate to remove the debt.

Fourth, the creditors are not allowed to participate into the equitization plan establishment and approval. According to the Circular No. 126/2004/TT-BTC, the plan is designed by consulting board and approved by the Equitization Steering Committee which will be reported to relevant government agencies. The creditors, therefore, cannot involve in the firms' financial, business and labor plan. Therefore, they do not have even necessary information about the performance of the firms after equitization and are not sure if removing the debt is beneficial to them.

Obviously, the above disadvantageous legal regulation gave DTAC limited rights to discuss with insolvent firms' creditors.

3.2.4. Issuing few incentives for investors to become shareholders of SOEs

Although the government already announced a recent policy of reducing the dominant role of the government as the major shareholder in SOEs in 2011, it still tries to maintain the major shares in SOEs. In details, the Prime Minister's Decision No. 14/2011/QĐ-TTg dated 14 March 2011 on the Criteria and Categories of the SOEs which are 100% owned by the state emphasized that the government would keep dominant shares in only some key areas has been issued. However, the long list of firms which must be 100% and more than 50% owned by the state still raises questions. The state still hold 100% of charter capital in enterprises managing infrastructure systems such as the national railways, airlines, post, lottery, newspapers, cigarette, urban areas, airports, important and large-scale seaports, radio and television stations…. Enterprises that the state continues to hold 50% of their charter capital include businesses that produce public products like media outlets, movies production for children, scientific and documentary purposes, urban waste water system, vaccine, lighting companies, agro-businesses, large-scale power plants (above 500 MW), fertilizers, coffee and rubber growing and production. In this decision, there has not been clear whether the government wishes to protect and develop the state properties or obtain an efficient state capital structure in SOEs.

One of the most concerning issue now is that as the dominant shares are held by the state, it is time-consuming and sometimes difficult to select the board of directors, apply new technology and new management system to the firms. Important changes in personal organization and investment are decided by the government. When the investors have little chance to manage or participate into the operation of the firms, they have few incentives to invest into the firms**.**

Furthermore, in order to maintain the dominant shares, the government restricts the number of shares to be sold. Big SOEs' IPO plans are heavily controlled by the government. Recently in June 2011**, "**Deputy Prime Minister Nguyen Sinh Hung has approved a plan to equitize Vietnam National Petroleum Corporation (Petrolimex), which controls 60% of the country's fuel distribution network**.** As in most cases, the government would still keep a controlling stake. It allowed Petrolimex to sell [only] a 2.56 percent stake at an IPO, while the government would still own 75% in longer term. The approval gave no details on the timing or possibility of foreign participation." [34] Such a small percentage attracts few investors and makes both domestic and foreign investors doubt the government's intention of giving up its controlling role.

Finally, while sellers always expect the state enterprises' assets to be highly valued, government agencies are always afraid of selling state's assets cheaply. According to the SaiGon Times, on the market, there are more than 70%[35] of the shares are offered at the prices below its true value which give few incentives to investors.

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[34]Tuoi tre, "Government approves Petrolimex equitization plan", *Tuoi tre Newspaper Online*, June 02, 2011, http://www.tuoitrenews.vn/cmlink/tuoitrenews/business/gov-t-approves-petrolimex-equitization-plan-1.33072, the original article is in Vietnamese.

[35] The data about the price of the equitized firms' shares on the market is reorganized from the article by Ho ba Tinh, "Slow equitization due to IPO problems", *the SaiGon Times*, July 25 2011, www.thesaigontimes.vn/Home/taichinh/chungkhoan/57644/Co-phan-hoa-cham-vi-IPO?.html, the original article is in Vietnamese.

3.2.5. Applying strict financial supervision to SOEs

According to the Enterprise Finance Agency under MOF, by the end of the third quarter of 2011, the SEGs and SOEs will be put under the Financial Supervision Regulation which has just been completed[36]. The government's point is that as many enterprises are using state capital, it is important to supervise carefully how the capital is used. SOEs now control 70% state fixed assets, 20% investment capital, 50% state investment capital, 60% bank credit and 70% ODA capital.[37]

The Regulation is applied to all SEGs, SCs, and limited liability companies under line ministries, the People's Committee of provinces and the cities under the central government, the State Capital Investment Corporation (SCIC), the enterprises partially owned by the state. There are 22 SCs and SEGs[38] which are regulated by this regulation[39]. This regulation has several following problems.

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[36] The drafting version of the Regulation was reported to the Prime Minister by Ministry of Finance in April 2012.

[37] The data about SOEs' capital is reorganized from the article by MOF "Managing the Finance of SOEs: Improving the responsibility of SOEs in managing and using the State's capital and assets", *MOF's website,* 07 July 2011, http://taisancong.mof.gov.vn/portal/pls/portal/SHARED_APP.UTILS.print_preview?p_page_url=http%3A%2F%2Ftaisancong.mof.gov.vn%2Fportal%2Fpage%2Fportal%2Fcqlcs%2F3311156%2FTab&p_itemid=7064814&p_siteid=33&p_persid=0&p_language=vi, the original article is in Vietnamese.

[38] SEGs regulated by this Regulation: Vietnam Electricity Group (EVN), Vietnam Oil and Gas Group (PetroVietnam or PVN), Vietnam National Coal and Mineral Industries Group (VINACOMIN), Vietnam Post and Telecommunications Group (VNPT), Vietnam Shipbuilding Industrial Group (VINASHIN), Vietnam National Textile Garment Group (VINATEX), VIETTEL Group, Song Da Holdings (the parent company of Vietnam Construction Industry Group)[38], Vietnam Housing and Urban Development Group (HUD), Vietnam National Chemical Group (VinaChem), Vietnam Rubber Group (VRG); SCs: Vietnam National Shipping Lines (Vinalines). SCs regulated by this Regulation: Vietnam Airlines Corporation (Vietnam Airlines), Vietnam Railways (VNR), Viet Nam Cement Industry Corporation (Vicem), VietNam Steel Corporation (VNSteel), Vietnam Northern Food Corporation (VINAFOOD1), Vietnam Southern Food Corporation (VINAFOOD2), Vietnam National Coffee Corporation (VinaCafe), Vietnam Paper Corporation (VINAPACO), Vietnam National Tobacco Corporation (VINATABA), State Capital Investment Corporation (SCIC).

First are unfeasible criteria for supervision. The supervision criteria include investment projects, investment capital, investment efficiency, debt management, solvency, capital preservation and development, performance, profit/ state equity ratio. However, these are general criteria. It is difficult to supervise the capital preservation and development status without specific criteria. One of the criteria which is now in consideration is the annual profit must follow an increasing trend. However, this is difficult for any enterprises to keep increasing profit every year. Besides, it is impractical to make administrative agencies supervise firms, with a regulated set of criteria, so that firms operate beneficially to itself. Following a set of criteria is a burden to firms and an obstacle to its making profit.

Next, the regulation is applied to the enterprises which is controlled less than 50% by the state (according to SOEs Law, they are not SOEs). These enterprises will be supervised in a number of areas including charter capital change, invested projects, valuable assets transaction. However, it is unreasonable to supervise those whom are less than 50% controlled by the government. Moreover, according to the Enterprise Law, the decision role belongs to those who control the major shares of the enterprises. If the government tries to control all enterprises having state equity, the roles and rights of the major shares holders will be violated. On the other hand, it is a heavy task for the supervision agencies to supervise such a big number of enterprises.

Another problem of the regulation is the cooperation of different financial management agencies including MOF, the Authorities of Finance in provincial governments and Ministers of line ministries and the owners including line ministries, People's Committees and SCIC in supervising SOEs' financial status. Under this regulation, line ministries have to supervise the financial status of the enterprises with the role of owners while Ministers supervise them with the role of financial supervisor. This can cause confusion in responsibilities of line ministries,

[39] The drafting Regulation does not explain the criteria to put these SEGs and SCs into the list.

especially when it is not clear how the financial agencies can cooperate with the line ministries. Moreover, line ministries do not have enough expertise in supervising the production, investment activities and financial status of the firms. Therefore, it is difficult for them to act as normal owners and investors in non-SOEs.

The next problem of the regulation is that when the enterprises have the signals of "unsafe financial status", they will be put under "special supervision." The signals are measured in debt, loss and solvency such as debt/equity ratio higher than three (3), solvency index smaller than 0.5%. Those who fail to establish budget provision plan or allocate budget properly which affects the enterprises' performance, or send inaccurate reports on financial status will be put under the same condition. These "specially-supervised" enterprises have to report to the supervisor quarterly. Serious cases can be reported to the Prime Minister. They will be put out of this status after two years sending all required reports or recovering the loss. This is a burden to many SOEs, especially the construction companies who are put under special supervision as they have to work on priority constructions given by the government and have to mobilize capital from customers.

All these government's heavy intervention implied a long-term control over SOEs regardless of by whom the firms were owned. This obviously caused worries to major shares holders. Investors, therefore, have got few incentives to invest into these enterprises.

3.3. SOEs' significant weaknesses during last decades

Although SOEs had certain contribution to the national development, they showed a huge number of significant weaknesses from their establishment to the recent time.

In the early 1990s, the purpose of establishing SCs were to separate the state management and production activities. In another word, SCs replaced People's Committees, ministries and other government agencies in managing production activities. Therefore, in many cases, SCs were just another form of administration agencies which could not promote production and efficient cooperation among SCs' members.

Later, when being transferred to parent-subsidiary form, SOEs also faced difficulties. Due to the shortage of investment capital, many parent companies could not invest into their member ones. Moreover, parent companies have not been able to accomplish production and investment functions at the same time.

After the restructuring program, SOEs still show a number of weaknesses. First was the small scale with irrational structure which led to lack of focus in key economic areas. Until 2005, "[o]n average, each [enterprise's value was] only VND 22 billion, 58.9% [of which was] less than VND 5 billion."[40] Second was the backward technology together with weak management capacity, autonomy and accountability in business and production. "According to…the Ministry of Science and Technology (MOST), [Vietnam's] technology [in SOEs] was from ten to twenty years behind that of other countries [in 2005]."[41] Third was the inadequate management capacity of most SOEs due to the unclear fundamental rights applied to SOEs. Last was the "low efficiency and competitiveness, [including] rising overdue debt and [a high rate] of unemployed and redundant employees… In 2000, the numbers of profitable enterprises accounted for just over 40%, break-even ones…31%, and chronically loss-making ones… 29%."[42]

Until now, there is still limited improvement among SOEs. The Government Inspectorate of Vietnam (GI) has reported that in 2010 there has been lack of transparency in enterprise valuation, unclear structure of governance mechanisms and great loss of state property during

[40]Tran Ngoc Phuong, Standing Vice Chairman, Ho Chi Minh City's Enterprise Reform and Management Board. Reform of State Owned Enterprises in the Context of Vietnam's WTO Accession, (working paper, WBI-Training Program with World Bank, 2005), 2-4.
[41] Ibid.

[42] Ibid.

the equitization process of a number of big SOEs**.** In addition, according to the report of Enterprise Reform and Development Steering Committee dated 15 Feb 2011, "equity size of SEGs and SOEs is VND 540,701 billion ($US 25,000 million) which shows an increase of 11.75% in comparison to that of 2009. The total profit before tax is VND 70,778 billion ($US 3,500 million). So the ratio of profit before tax over equity is only 13.1% which is even much lower than the interest rate of commercial banks [the year before]. Moreover, 80% of the profit before tax is from only four SEGs, which are Oil and Gas Group (PVN), Viettel Group, Vietnam Posts and Telecommunications (VNPT) and Vietnam Rubber Group." [43] It is easy to estimate that the ratio in all other SEGs and SOEs must be lower than 13%. This is a serious weakness of SOEs. As SOEs controlled all major sectors of the economy, their inefficiency could seriously harm the national economic stability and growth.

[43] Nguyen Minh Phong, PhD., Hanoi Socio-Economic Development Research Institute, "Developing SEGs: three bottlenecks," *Bao moi newspaper*, 08 July 2011, http://www.baomoi.com/Phat-trien-tap-doan-kinh-te-nha-nuoc--Ba-nut-that-kho-go/45/6572669.epi, the original article is in Vietnamese.

CHAPTER IV: GOVERNMENT'S SPECIAL PREFERENCES AND INTERVENTION INTO VINASHIN AND ITS RISKY BEHAVIOR

In this chapter, the author will analyze the data of the case of VINASHIN to see if it is consistent with the main hypothesis and rejects the alternative one.

Again, the proposition (1) is:

Financial Backing + Top- down Intervention = Careless Decision + Passive Management

The proposition (2) is:

Capable Leadership + Financial Backing + Top-down Intervention = Careful Decision + Active Management

4.1. Government's special preferences to VINASHIN and the limited role of its CEO

The policies of the government toward VINASHIN and the way it directed VINASHIN demonstrates the left hand side of the proposition (1):

Financial Backing + Top- down Intervention

These policies also show that the left hand side of the proposition (2) cannot happen:

Capable Leadership + Financial Backing + Top- down Intervention

4.1.1. Government's special preferences to VINASHIN

From the early establishment to the insolvency and restructuring, VINASHIN has received a number of privilege rights from the government. Most important advantages VINASHIN has gained are in financial resources and auditing schedule.[44]

The first advantage of VINASHIN was getting huge preferential loans from both domestic and international banks. One year after the decision of VINASHIN establishment by the Prime Minister, "VINASHIN could mobilize 70,700 billion VND (4.406 billion $US), 43,700 billion VND (2.723 billion $US) of which was from long-term loans…This happened during the most difficult time for almost all enterprises in Vietnam to get access to loans."[45]The explained reason for this support was that VINASHIN played the single and most important role in ship-building industry which the government has always considered the key to boost the economy.

The first source of capital was "the loan of 750 million $US from the government bonds to the international market, which was issued following the Decision No. 914 dated 01 September 2005 by the Prime Minister for the purposes of modernization and technology

[44] If putting aside the aspect of interest group, it could be implied that when the government gave VINASHIN at the same time easy loans and a comfortable auditing schedule, the government already assumed that with its direction, VINASHIN would use the loans effectively to realize the policy goals and therefore would not need a tight auditing schedule.

[45] Phung Suong, "VINASHIN's debts," *Tien Phong Newspaper,* '', 2010, http://www.tienphong.vn/Thoi-Su/190099/Can-canh-con-tau-Vinashin-Tap-doan-2N-Nong-va-no.html, the original article is in Vietnamese.

advancement."[46] When the government utilized its credibility on the international market, the government meant it would share the risk with VINASHIN. In details, "Vietnamese government's bonds were issued on 03 November 2005 at the interest rate of 6.875 %/year which would falls due on 15 January 2016 and paid interest every six months. In order to get this loan, the borrower had to pay international bond issue fee of 168 billion VND (10.47 million $US)."[47] Moreover, the procedure from issuing the policy to delivering the loans to VINASHIN was conducted in a short time. This gave VINASHIN important advantages as it could always mobilize sufficient capital for production and mobilize the capital in time to take hold of valuable opportunities in the market.

The second source of capital was the "loans from 15 banks and two funds abroad, the total amount of which was 600 million $US, arranged by the Credit Suisse Singapore following the permit by the State Bank of Vietnam (SBV) dated 22 June 2007…VINASHIN received the loans on 25 June 2007 with libor interest paid every six months plus an annual interest of 1.5%. The principal must be paid every six months and paid 60 million $US each time… In order to get this loan, the borrower had to pay eight million $US for credit arrangements."[48] The permit from SBV meant an implicit agreement between the government and VINASHIN. Believing that the government would be responsible for VINASHIN's debt, creditors gave VINASHIN easiest access to loans.

As the government utilized its credibility to support VINASHIN in the international financial market, it is no surprise that it continued to support VINASHIN in the domestic one. The third great source of capital for VINASHIN was from "six issues of domestic bonds. The first three issues included 500 billion VND (31.3 million $US) (September 2006) and 300 billion VND (18.83 million $US) (November 2006) at an annual interest of 9.6%, [in which]

[46] Ibid.
[47] Ibid.
[48] Ibid.

500 billion VND (31.3 million $US) (January 2007) at an annual interest of 10.5%, principles must be paid after five years. The forth issue was 1000 billion VND (18 January 2007) at an annual interest of 10.5%, principles must be paid after ten years… [The fifth and sixth issues were in total] 3000 billion VND." [49] The loans from government's bonds came out continuously to support VINASHIN. Therefore, the firm had never been worried about financial sources. Moreover, the government had been always backing up VINASHIN and trying to meet its financial demand. In addition to the financial sources from the government, VINASHIN also borrowed from various banks, "the total number of which was 13,672 billion VND (852.16 million $US)."[50]

In addition to financial support, VINASHIN also received preferential in auditing schedule. The auditing plan for VINASHIN was delayed several times from 2006 to 2010 which was also due to the government's efforts in giving VINASHIN favorable conditions to focus on production. This attitude of the government showed that the government was confident that VINASHIN would follow the government's direction and policies and that VINASHIN's rapid development was beneficial to the whole economy. This is why the government gave VINASHIN all best conditions and protection.

The explained reason for this delay was the number of SOEs was so big that "auditing must be conducted at every four to five years."[51] Next, SAO planned to audit VINASHIN in 2008 while the Government Inspectorate (GI) already put VINASHIN in its 2009 plan. In order to avoid duplication, SAO had to reschedule the plan to 2010. However, after that, the plan made by the GI in 2009 was not approved and was moved to 2010 as VINASHIN

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[49] Ibid.

[50] Ibid.

[51] The data about auditing postponement is reorganized from the article by Le Nhung, "Auditing Schedule has been postponed many times," *Viet bao Newspaper*, October 25, 2010, http://pda.vietbao.vn/Chinh-Tri/Nhieu-lan-len-ke-hoach-kiem-toan-Vinashin-nhung-deu-bi-cat/20944289/96/, the original article is in Vietnamese, the information was from the interview with the Chief of the State Auditing.

needed to concentrate on production. This idea was also in the report of the National Assembly's Committee of Finance and Budget[52]. Again, this explanation implied that the intention of all auditing postponement was to let VINASHIN focus on its production. With all these efforts, the government expected VINASHIN to utilize its advantages and advance its performance as well as efficiency.

4.1.2. Limited role of VINASHIN's CEO

In addition to giving a number of preferences to VINASHIN, the government also gave this SEG frequent orders and directions, believing that VINASHIN can utilize its advantages reasonably. The paradox is that while the government has been trying to give VINASHIN financial support and protection, the government has also required VINASHIN to sever as a policy tool rather than a firm. Under this condition, VINASHIN's CEO must work to realize directed policies. There have been few incentives for the CEO of the SEG to utilize his ability to improve firm's efficiency.

Like many other SOEs, VINASHIN was a SC 91 in 1996. It was reorganized to be a SEG in 2006. The CEO of VINASHIN was assigned by the Prime Minister. From this point, CEO of VINASHIN or other SOEs tend to be the person who has the incentives to get promotion better than interested in ship-building business.

Like other SOEs, VINASHIN has the Board of Directors (BOD) with its chairman to work as supervisors. However, the CEO and chairman of VINASHIN before its insolvency was actually one person. It looked like the CEO of VINASHIN had more power. However, like other SOEs, the BOD of VINASHIN is regulated to be responsible before the Prime Minister and the government.

[52] Ibid.

VINASHIN was established by the government as a policy tool to turn ship-building industry into a key industry which can be a main driving force for Vietnam's development. At that time, Korea, Japan and China had already advantages in shipbuilding in Asia. This task was quite challenging to a newborn ship-building group.

During the first years of VINASHIN's establishment (2006-2007) there were a number of contracts of ship-building. VINASHIN appeared to grow well and make profit for two years. This early time made the government believe strongly in VINASHIN's positive future as well as their support and direction to VINASHIN.

In each period of time, VINASHIN received important and demanding orders. One of the most noticeable examples was establishing the North-South high-speed sea route for Vietnam. This order was realized by VINASHIN's purchasing expensive but inefficient Lotus (Hoa Sen) ship which will be studied in details in the parts afterward.

From the early establishment to recent time, VINASHIN was put under top-down orders which did not take into account profit and efficiency. As long as the government's policies could be implemented, the firm would receive relevant financial support. This mechanism led to a passive management system for VINASHIN's leadership. They were dependent on the direction of the government while the government itself considered the firm one policy instrument. There was an implicit agreement for the government and VINASHIN. The firm believed that as long as it followed the government's direction to practice its policies, it would be well supported. The government believed that as long as the government directed the firm toward government's policies and goals and supported it financially, it would be able to realize those policies. However, there is a gap between these two assumptions. Both two sides have not paid attention to the firm's efficient operation while without efficiency, the firm could not secure its existence, and therefore not healthy enough to realize any policy.

The administrative management affected the leadership of the firm heavily and turned them into pure policy practitioners. When VINASHIN's board of directors were accused of letting VINASHIN fell into huge debt in the court in 2012[53], all the defendants except from the CEO claimed that they only followed the orders of higher leadership. Even the CEO of VINASHIN claimed that he was just overexcited to realize the order of the government to set up the high-speed North-South sea route. Moreover, the government's order to develop the shipping industry was an extremely challenging order that he faced a number of difficulties in making fast and proper decisions to grasp valuable opportunities.

What should be more noticed is that not only the VINASHIN's leaders but the court itself was judging if VINASHIN leadership followed or missed some parts of the government's orders. This implies that the role of the board of directors of the firms is to realize the order as closely as possible. Concentrating on how to follow all orders tightly, the board of directors could assume that following orders means little responsibility for themselves. In another word, there would always be higher leadership who are responsible for what they do.

4.2. VINASHIN's risk-taking behavior

The following risk-taking behavior of VINASHIN will demonstrate the right hand side of the proposition (1):

Careless Decision + Passive Management

VINASHIN's behavior also shows that the right hand side of proposition (2) cannot happen:

[53] The court was publicized on the Law Newspaper online, 30 Aug. 2012, http://phapluattp.vn/20120827065220404p1063c1016/cuu-chu-tich-vinashin-xin-giam-nhe-hinh-phat.htm

Different from the government's expectation, VINASHIN induced high level of risk-taking behavior. As VINASHIN received tremendous support and close direction from the government, it conducted careless investment decision, thinking that the government would always stand behind it. It also relied heavily on the government's direction and made light of the role of making profit and operating as an efficient ship-builder.

4.2.1. Investing into a number of areas which are not relevant to its focusing area

The most serious and most risky behavior of VINASHIN is to spread its investment into various areas including insurance, plane rental, iron and oil manufacturing and housing.

First, according to MOF, VINASHIN spent huge resources for financial investment. One year after establishment, VINASHIN's long-term financial investment reached a huge number 4,103 billion VND (255.73 million $US) including 615 billion VND (38.33 million $US) investing into various joint-venture companies and 3,488 billion VND (217.40 million $US) for stocks and shares investment.

One of the biggest stocks investments was that of 1,462 billion VND (91.12 million $US) into Bao Viet Insurance Group. The reason that VINASHIN claimed for the investment into Bao Viet Group was that ship-building was a risky sector. Besides, VINASHIN spent 70 billion VND (4.36 million $US) to purchase the stocks of Plane Rental Joint Stock Company (JSC) which is totally unrelated to ship-building area.

Next, the parent company of VINASHIN invested 120 billion VND (7.4 million $US) into Vietnam Development Fund and another same amount to Thach Khe Iron JSC. It also invested 80 billion VND (4.9 million $US) into Oil Rig Manufacturing JSC and 91 billion VND (5.6 million $US) to Hanoi Housing Commercial Bank[54].

All these investment was made in a short period of time and continuously. VINASHIN has shown its huge ambition in becoming a big economic group in various areas, many of which are quite irrelevant to its major area. This behavior is excessively risky to a newborn SEG like VINASHIN, who had not got remarkable success even in its major area.

Finally, VINASHIN induced not only risky but harmful behavior to its production when trying to provide capital to its subsidiaries from its loans at higher interest rate. “The loan from the government’s bonds issued to the international market was borrowed by VINASHIN’s subsidiaries at 2.96% higher than the original interest rate while other loans were borrowed at two percent (2%) to three percent (3%) higher. This increased the production costs and reduced the competitiveness as well as productivity of these subsidiaries.”[55] By this way, VINASHIN misused the loans guaranteed by the government’s credibility since it worked as a bank for its subsidiaries.

4.2.2. Investing into a big number of projects despite already having big debt

According to GI’s report, “from the end of 2005 to 30 June 2010, VINASHIN mobilized huge capital resources domestically and internationally including government’s bonds to international market, enterprises’ bonds and other sources [and] the total value of which was 72,000 billion VND (4,487.65 million $US)…However, as VINASHIN spread its investment into a huge number of projects (615 projects), each project got only 30% of the

[54] The data about VINASHIN’s investment is reorganized from the article on Vietnam Economic Forum, “VINASHIN was bold in using capital”, Vietnam Economic Forum website, July 05 2010, vef.vn/2010-07-05-vinashin-long-hanh-trong-viec-su-dung-dong-von-, the original article is in Vietnamese.

[55] Phung Suong, “VINASHIN’s debts,” *Tien Phong Newspaper*, March 31, 2010, http://www.tienphong.vn/Thoi-Su/190099/Can-canh-con-tau-Vinashin-Tap-doan-2N-Nong-va-no.html, the original article is in Vietnamese.

required capital on average…"[56] As a result, many projects were uncompleted and abandoned. After quite a long time, most of the assets were damaged which led to huge losses.

Moreover, also according to GI's report, the 750 million $US from government bonds was divided into various small amounts for 219 projects. Many among these projects were still on progress at the time of inspection. Therefore, until the end of 2008, there were only 56 completed projects. There was 75% of the total number of the projects were incomplete or not yet operated.[57]

Due to this risky investment behavior, VINASHIN could not be capable to fulfill its major function as a ship-builder. It had to give up a number of orders and contracts due to its lack of capital and capacity. The number of ship-building firm orders until 31 March 2009 was 173, the total value of which was more than four billion $US. However, there were 14 order cancelations, the total value of which was 392.29 million $US and 32 postponement, the total value of which was 696.97 million $US.[58] Even when the orders were already firmly set and signed in contracts, VINASHIN also had to cancel and postpone the contracts. Also according to GI's report, from 2006 to 2010, VINASHIN signed 85 contracts, the total value of which was 58,224 billion VND (3,653 billion $US). However, there were only 15 contracts completed, accounting for 12% of the signed projects. Cancelled and planned to be

[56] Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

[57] The data about VINASHIN's investment is reorganized from the article on the report of the Government Inspectorate of Vietnam by Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

[58] The data about VINASHIN's order cancelation is reorganized from the article on Voice of Vietnam, "VINASHIN's Spread Usage of Investment," *Vietnam Economics Forum*, July 05, 2010, http://vef.vn/2010-07-05-vinashin-long-hanh-trong-viec-su-dung-dong-von-, the original article is in Vietnamese.

cancelled projects accounted for 47%, which were the share of 54 ships of a total value of 27,223 billion VND (1,709 billion $US).[59]

VINASHIN's risk-taking behavior became serious when a number of its proposed projects for loans were only theoretical ideas. When coming to practical situation, VINASHIN failed to operate all the ideas that it created. [In 2008], "most of the major subsidiaries of VINASHIN were in lack of capital…"[60] Details about the lack of capital resources among VINASHIN's subsidiaries are in the following table:

Table 4: Lack of capital in VINASHIN's subsidiaries

Source: The data was reorganized from the article by Cong Minh and Phung Suong "A closer look at VINASHIN: strange public management", Tien Phong Newspapers, March 31 2010, http://www.tienphong.vn/Kinh-Te/190308/Can-canh-con-tau-Vinashin-Quan-ly-cong-no-la-lung.html

Subsidiary company name	Lack of capital in billion VND	Lack of capital in million USD (exchange rate at the time the subsidiary was invested 1$US=17440 VND)
Nha Trang Shipbuilding Company	**891**	51.08
Cai Lan Shipbuilding Company	**495**	28.4

[59] The data about VINASHIN's contracts is reorganized from the article on the report of the Government Inspectorate of Vietnam by Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website,* June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

[60] Cong Minh and Phung Suong "A closer look at VINASHIN: strange public management", *Tien Phong Newspapers*, March 31 2010, http://www.tienphong.vn/Kinh-Te/190308/Can-canh-con-tau-Vinashin-Quan-ly-cong-no-la-lung.html, the original article is in Vietnamese.

Bach Dang SC	**2,400**	137.6
Nam Trieu SC	**3,982**	228
Pha Rung Shipbuilding Company	**3,749**	226.3

4.2.3. Purchasing ships with little judgment

In a short period of time, VINASHIN imported a large number of old ships from other countries with little judgment. According to GI, "from 2006 to 2009, VINASHIN bought 25 old ships, the total value of which was more than 8000 billion VND…[VINASHIN] induced a huge loss of 550 billion VND for Lotus (Hoa Sen) ship which was advertised by VINASHIN as a five-star ship."[61] One of the examples is that in just one year, from 2006 to 2007, VINASHIN approved 10 contracts of buying foreign ships proposed by its subsidiary, VINASHIN Ocean Shipping Company Limited (VINASHIN LINES[62] or Vien Duong in Vietnamese) as the following:

[61] Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

[62] Later in the restructuring program, VINASHIN LINES was moved to VINALINES

Table 5: Foreign ships bought by VINASHIN and their value

Source: Hundreds of millions of $US and old ships, Tien Phong Newspapers, http://www.tienphong.vn/Thoi-Su/190223/Dau-tu-hang-tram-trieu-do-%E2%80%9Com%E2%80%9D-tau-qua-dat.html

No.	**Ship name**	**Investment**		**Time**	**Ship age**	**Nation**[63]
		Billion VND	Million $US (exchange rate at transaction time)			
1.	Vinashin Island	174.4	10.94	2006	26	Panama
2.	Vinashin Summer	109	6.84	2006	23	Tuvalu
3.	Vinashin Eagle	220.8	13.85	2006	24	Tuvalu
4.	Vinashin Phoenix	408.6	25.46	2007	22	Liveria
5.	Vinashin Express 1	234	14.58	2007	20	Liveria
6.	Vinashin Express 2	245.9	15.32	2007	19	Liveria
7.	Vinashin Glory	505.4	31.50	2007	24	Tuvalu
8.	Vinashin Tiger	328.2	20.45	2007	26	Tuvalu
9.	Vinashin Atlantic	909.6	56.69	2007	15	Panama

[63] These ships had to keep foreign flags as they were not certified by Vietnam's Agency for Registration.

"[Among these ships], those of 23 and 24 years old were bought using the loans from the government's bonds to the international market, the total value of which was 329 billion VND (20.5 million $US). [The rest of the ships] were also bought using loans."[64]

Purchasing old ships would not be a wrong decision if old ships could still bring profit. In some developing stages, old ships could be bought at cheap prices, repaired and later brought profit. However, VINASHIN made careless investment in purchasing old ships due to lack of technical information collection as well as managing the ships after purchasing them. In particular, comparing the prices VINASHIN paid to buy these old ships with the market price and profit made after investment, it is obvious that VINASHIN made huge losses. The ships bought by VINASHIN can be divided into two groups:

First are those who could not operate properly right after being purchased including Vinashin Island, Vinashin Summer, Vinashin Express 1, Vinashin Express 2, Vinashin Glory and Vinashin Tiger. They have been sold as scrap iron.

Second are those who have been valued at much lower price than when it was bought. Vinashin Eagle was bought at 220.8 billion VND while it has been now valued at 60 billion VND. The Vinashin Phonenix was bought at 408.6 billion VND. It has been recently valued at 100 billion VND.[65]

Next, the paper would like to look in details at several noticeable cases of old ship purchased by VINASHIN as the following:

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[64] Bao moi, "VINASHIN's old ships," *Bao moi Newspaper*, July 15, 2012, http://www.baomoi.com/Home/KinhTe/daidoanket.vn/Vinashin-Nhung-con-tau-nat-Ky-2/4559855.epi, the original article is in Vietnamese.

[65] The data about these old ships' value is reorganized from the article by Bao moi, "VINASHIN's old ships," *Bao moi Newspaper*, July 15, 2012, http://www.baomoi.com/Home/KinhTe/daidoanket.vn/Vinashin-Nhung-con-tau-nat-Ky-2/4559855.epi, the original article is in Vietnamese.

[VINASHIN Atlantic]

VINASHIN bought Vinashin Atlantic and assigned VINASHIN LINES, its subsidiary to manage the ship while VINASHIN LINES had little experience in managing oil-carrying ships and had few qualified sailors to work on the ship. Therefore, VINASHIN LINES had to hire experts and sailors from a foreign company which partially increased the managing costs. The profit the ship brought was too low comparing to the costs. The situation became serious when the company hired to maintain the ship canceled the service in April 2009. Therefore, the ship was quickly damaged and could not operate until now.

[Lash Song Gianh]

In addition to spending a huge capital to purchase old ships, VINASHIN also invested in its major function as ship-building. However, a number of them also made losses. Lash Song Gianh was an important case as VINASHIN invested 400 billion VND (25.1 million $US) in 2005. VINASHIN used old technology of 1950 which required a large amount of fuel with disqualified speed. Therefore, it brought negative profit. Recently, the ship could not be used for any other purpose other than be sold to scrap dealers which could bring only 50 billion VND (3.1 million $US). When being transferred to VINALINES the ship was repaired but still could not satisfy the market's demand.[66]

[Bach Dang Giang]

Another ship is Bach Dang Giang in which VINASHIN invested more than 155 billion VND (9.73 million $US). Nam Trieu, a subsidiary of VINASHIN received the ship from VINASHIN LINES. This ship was imported by Ship's Components Importing Company in 2000. Nam Trieu had to invest 13 billion VND (0.8 million $US) into repairing

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[66] Bao moi, "VINASHIN's old ships," *Bao moi Newspaper*, July 15, 2012, http://www.baomoi.com/Home/KinhTe/daidoanket.vn/Vinashin-Nhung-con-tau-nat-Ky-2/4559855.epi, the original article is in Vietnamese.

the ship…The total investment of 168 billion VND (10.54 $US) was from loan VINASHIN got from the government's bonds to the international market. However, after all, the ship could not work due to old age and damaged engine. Therefore, Nam Trieu intended to turn it into a floating four-star hotel with an investment of 144 billion VND (9.3 million $US). However, the idea could not be realized as the ship was quickly degraded. Nam Trieu had to sell the ship's frame as scrap and sell the ship engine separately. Nam Trieu got back only more than 66 billion VND (4.1 million $US).[67]

[Lotus]

This important ship purchase case was questioned the court in 2012. However, the CEO of VINASHIN explained that he just followed the policy and order of the government but practice it with several mistakes due to the objective context. This case is the obvious evidence for the misleading perception of the government and VINASHIN toward each other. While the government gave VINASHIN its best support, hoping VINASHIN to realize its policy successfully, VINASHIN leadership passively relied on the government's direction and made decision without thinking of feasibility and profit. It is easier to see this behavior in the following table:

Table 6: From the government's order to VINASHIN's realizing the order in purchasing Lotus ship

Source: The table was drawn based on the data collected and reorganized from the following articles:

- *The article by Bao moi, "VINASHIN's old ships," Bao moi Newspaper, July 15, 2012, http://www.baomoi.com/Home/KinhTe/daidoanket.vn/Vinashin-Nhung-con-tau-nat-Ky-2/4559855.epi, the original article is in Vietnamese;*

[67] The data about Nam Trieu is reorganized from the article by Bao Son, "VINASHIN court," *Hochiminh Security Newspaper*, March, 30, 2012, http://www.congan.com.vn/?mod=detnews&catid=703&id=466648, the original article is in Vietnamese.

- *The article by Hoang Sang, "purchasing thousand-of-billion ship for testing", Vietnam Net Newspaper Online, March 27 2012, http://vietnamnet.vn/vn/xa-hoi/65993/vu-vinashin--mua-tau-nghin-ty-de----thu-nghiem.html, the original article is in Vietnamese.*

Government's order	**Government's support**
Establishing North-South transportation seaway	**Giving loans with low interest**

⇩

VINASHIN realizes the order
Making fast decision: Buying "Lotus" in 2007 (the ship was made in Italy) with a price of 1,500,000 billion VND (95,932 million $US) (original price when purchasing the ship is 60 million EU)

⇩

Consequence
Huge costs for repairing in China and Korea : 300,000 $US
Huge losses in each transportation
The ship was abandoned after several voyages

From the example, it is clear that the board of directors did not make careful and wise decision. They did not count basic economic element including profit, cost and losses in the purchase. In addition to their carelessness, the system that they were working it gave them few incentives to make the firm competitive while that system made them focus on doing the exact things that they were assigned to do.

Due to the above risky investment, VINASHIN quickly fell in to huge debt. "…Since 2006, VINASHIN had been always in extremely huge debt, more than 94% its equity…As most of the debt was overdue, VINASHIN had to ask for other loans to pay previous debt. According to GI, the unbalanced status of VINASHIN had negative impact on the activities of a number of domestic banks and credit organizations as well as the government's credit on the international capital market."[68] The following auditing report in 2009 will explain in details VINASHIN conducted risky investment behavior:

[68] Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

Table 7: VINASHIN auditing report conducted by KPMG until 31 December 2009

Source: VINASHIN's huge debt, Economics News, quoted from the Sai Gon Times, http://www.tinkinhte.com/kien-thuc/quan-tri-tai-chinh/khong.nd5-dt.126093.163169.html, the original article is in Vietnamese.

Assets	**31-12-2009**		**31-12-2008**	
	Billion VND	**million $US**	**Billion VND**	**million $US**
Total Assets	**102,536**	**5263.93**	**93,238**	**4786.59**
Current Assets	**50,200**	**2577.13**	**44,991**	**2309.72**
Cash and Cash Equivalent	3,642	**186.97**	2,686	**137.89**
Short-term Investment	641	**32.91**	686	**35.22**
Short-term Receivables	26,139	**1341.91**	21,869	**1122.70**
Merchandise Inventory	18,187	**933.67**	15,950	**818.83**
Others	1,559	**80.03**	3,798	**194.98**
Long-term Assets	**52,355**	**2687.77**	**48,247**	**2476.87**
Long-term Receivables	1,423	**73.05**	1,031	**52.93**
Fixed Assets	42,495	**2181.58**	40,549	**2081.677704**
(*including on- Progress Construction Projects)*	*20,041*	**1028.85**	*20,107*	**1032.24**
Invested Real Estate	342	**17.56**	6	**0.31**
Long-term Investment	3,566	**183.07**	3,931	**201.81**

Others	4,507	**231.38**	2,728	**140.05**
Total Liabilities and Owners' Equity	**102,536**	**5263.93**	**93,238**	**4786.59**
Liabilities	**96,635**	**4960.98**	**88,512**	**4543.97**
Current Liabilities	48,290	**2479.08**	43,940	**2255.76**
Long-term Liabilities	48,345	**2481.90**	44,572	**2288.21**
Equity	**5,900**	**302.89**	**4,726**	**242.62**
Owners' Equity	4,689	**240.72**	3,552	**182.35**
Minority Interest	1,211	**62.17**	1,174	**60.27**

According to the report of KPMG Audit in the above table, "the total debt of VINASHIN until the end of 2009 was 96,635 billion VND (4.96 billion $US) … Nearly a half of the total value of the fixed assets (42,495 billion VND) was used to invest into on-progress projects…In 2009, VINASHIN lost 1,628 billion VND (83.58 million $US) over a revenue of 22,461 billion VND (1.15 billion $US)."[69] These results prove that VINASHIN did not pay enough attention to its debt as well as its responsibility to pay the debt. The way it made use of investment capital clearly shows that it invested into excessively various projects in a short time and lost the control over these projects.

4.2.4. Establishing a big number of VINASHIN's subsidiaries

Being ambitious to become a giant group in a number of areas, VINASHIN quickly built up numerous subsidiaries. Only more than one year after establishment, VINASHIN

[69] The Sai Gon Times, "VINASHIN's huge debts," *Economics New*, October 29, 2010, http://www.tinkinhte.com/kien-thuc/quan-tri-tai-chinh/khong.nd5-dt.126093.163169.html, the original article is in Vietnamese.

established 46 subsidiaries including 37 new subsidiaries[70] and adopted nine companies from other groups. The number of VINASHIN's subsidiaries increased every year.

In 2007, "VINASHIN had 150 entities with 71,000 workers. [They are] parent company and its subsidiaries including 35 totally SOEs, 33 state-owned limited liability companies, 70 joint stock companies, seven schools and five joint venture companies."[71] "From 2007 to 2008, VINASHIN created 200 more enterprises, many of which were not related to ship-building sector and lacked capital."[72] This surely created more debt and lowered VINASHIN's competitiveness in the ship-building market.

The matter was that not only the parent company but many of VINASHIN's subsidiaries also induced risky behavior including heavy investment into financial market. For example, Bach Dang Ship-building SC borrowed short-term loans from VINASHIN Finance Company (another subsidiary of VINASHIN) to buy shares from other subsidiaries, the total amount of which was more than 58 billion VND (3.6 million $US) though it was in huge debt. Another example was Pha Rung Ship-building Company. This company invested "61 billion VND (3.8 million $US) into stocks market, 24 million VND of which was from

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[70] The data about VINASHIN's number of subsidiaries is reorganized from the article by Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

[71] Phung Suong, "VINASHIN's debts," *Tien Phong Newspaper*, March 31, 2010, http://www.tienphong.vn/Thoi-Su/190099/Can-canh-con-tau-Vinashin-Tap-doan-2N-Nong-va-no.html, the original article is in Vietnamese

[72] Thuy Nhai, "GI's Report on VINASHIN's debt of 96,000 billion VND," *GI's website*, June 07, 2011, http://thanhtra.com.vn/tabid/77/newsid/41600/temidclicked/2/seo/Ket-luan-thanh-tra-tai-Vinashin-No-den-hon-96000-ty-dong/Default.aspx, the original article is in Vietnamese.

short-term loans."[73] Pha Rung also invested two million $US into the establishment of Bai Can Joint Venture Company, which suffered huge losses shortly after its establishment.[74]

4.3. The restructuring program

4.3.1. Major changes to VINASHIN after the restructuring program

According to the approval of the restructuring program by Prime Minister on 18 November 2010, the plan had the following significant features:

First, VINASHIN will focus in only three areas including ship-building, supporting industry for ship-building and training ship-building workers.

Second, the duration for restructuring would be from 2011 to 2013 which is thought to give VINASHIN enough time to improve its personal, management and production.

Third, "VINASHIN will act as a group of companies after the restructuring program..." In this new format, "parent company and subsidiaries are separated legal entities, separated capital and assets who have the rights to own, use and make decision on their assets ... The parent company is a limited liability company owned 100% by the State…."[75] In addition, "VINASHIN must remove 216 companies together with 13,000 workers.... There would be [only] 43 companies remained…"[76]

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[73] Voice of Vietnam, "VINASHIN's Spread Usage of Investment," *Vietnam Economics Forum*, July 05, 2010, http://vef.vn/2010-07-05-vinashin-long-hanh-trong-viec-su-dung-dong-von-, the original article is in Vietnamese.

[74] The data about the two subsidiaries of VINASHIN, Bach Dang and Pha Rung is organized from Voice of Vietnam, "VINASHIN's Spread Usage of Investment," *Vietnam Economics Forum*, July 05, 2010, http://vef.vn/2010-07-05-vinashin-long-hanh-trong-viec-su-dung-dong-von-, the original article is in Vietnamese.

[75] Hong Anh, "VINASHIN Restructuring Plan was Approved," *Vnexpress Newspaper*, November 19, 2010 http://vnexpress.net/gl/kinh-doanh/2010/11/3ba23264/, the original article is in Vietnamese.

[76] Huyen Han, "Publicizing VINASHIN restructuring plan," *Police Newspaper Online*, November 20, 2010, http://www.cand.com.vn/News/PrintView.aspx?ID=140264, the original article is in Vietnamese.

Fourth, “other enterprises who were VINASHIN’s subsidiaries could be equitized, sold, go through selling debt, debt equity swap, selling invested capital, dissolution and bankruptcy…Some entities would be moved to Petrol Vietnam (PVN) and VINALINES.”[77]

Finally, according to the Minister of Transportation[78], after VINASHIN’s insolvency the intervention and supervision of the government has been much stricter than before. The government has assigned MOT to supervise and evaluate closely all VINASHIN’s objectives, master plan, organization and investment and report to the Prime Minister.

Overall, VINASHIN will receive other amounts of financial sources from the government, put under closer supervision. Basically, the way the government direct the firm has not much changed.

4.3.2. Remaining problems

Although the government has tried to restructure VINASHIN, it repeated its financial support to VINASHIN. After two years, VINASHIN has not shown remarkable improvement while asking for more loans.

After the restructuring plan, VINASHIN had to face to its debt to workers who had not received their salaries for a long time. “[Until 09/2010,] VINASHIN had nearly 35,000 workers who had not received their salaries with the total amount of 102.6 billion VND (5.267 million $US)... VINASHIN had 42,200 workers, 35,800 of which were employed…and 6,400 workers were temporarily unemployed.”[79]

[77] Ibid.
[78] The information about VINASHIN’s supervision is reorganized from the article by Anh Minh, “MOT will supervise VINASHIN tightly”, an interview with the Minister of Transportation, *Investment Review, MPI*, on November 22, 2012, http://www.baodautu.vn/portal/public/vir/baivietkinhtedautu/repository/collaboration/sites%20content/live/vir/web%20contents/chude/kinhtedautu/chinhsachvimo/71dd7b947f0000010199509462d15b33
[79] Ibid.

One of the most noticeable features of the restructuring plan was that government would continue to support VINASHIN after the restructuring plan. The most important support is continuing financial support for VINASHIN to pay its debt. At the beginning of 2011, the government claimed its support to VINASHIN as the most important objective is "not to lose ship-building industry…There would be a decree about special mechanism for VINASHIN to restructure itself." [80] VINASHIN also received loans from the fund of Ministry of Labor, Invalided and Social Affairs to deal with the debt to workers.

Next, the government will continue to lend preferential loans to VINASHIN. The government was worried that "if VINASHIN had to go bankrupt, all the assets would be wasted while the government would still have to establish another ship-building company as Vietnam was a country having advantages in long coastal line and ship-building industry is a must."[81] This viewpoint showed that the government considered VINASHIN itself the ship-building industry as well as the key to boost the economy. Besides, in the government's opinion, VINASHIN already had experience in shipbuilding. Therefore, in order to help VINASHIN to overcome difficulty due to huge debt, "the government would provide enough charter capital using Enterprise Arrangement Fund and other suitable financial resources so that VINASHIN could pay abroad debt when they fall dues, restructure its credit debt, complete on-progress projects…."[82] The government has expected that VINASHIN could gain positive production outcomes, make profit and pay back the loans. Therefore, the

[80] My My, "Special mechanism for VINASHIN's restructuring plan," *National Laws Newspaper Online*, February 19, 2011, http://www.phapluatvn.vn/kinhte/201102/Se-co-co-che-dac-biet-cho-Vinashin-tai-co-cau-2033968/, the original article is in Vietnamese

[81] Tu Nguyen, "The government will continue to give VINASHIN loans," *Vneconomy Newspaper*, August 05, 2010, http://vneconomy.vn/20100805121612716P0C5/chinh-phu-se-tiep-tuc-cho-vinashin-vay.htm, the original article is in Vietnamese.

[82] Ibid.

government has insisted that “[i]f necessary, the government would [again] issue government bonds to provide VINASHIN with loans so that VINASHIN could gain a balanced status…”[83]

Although the government has given a lot of support, from 2011 to 2012, the new leadership VINASHIN has been asking for more loans. “In the beginning of 2012, VINASHIN has been approved to continue borrowing more loans at the interest rate of 0% from Vietnam Development Bank due to its remained financial difficulty.”[84]

In order to reduce the burden of debt for VINASHIN, the government moved a number of subsidiaries of VINASHIN to other SOEs including VINALINES and PVN who are also big SOEs. These SOEs also receive preferences if agreeing to accept the moved parts of VINASHIN. “…[T]he companies who were moved to VINALINES would get the loans at the preferential interest rate of 0%...in order to pay salaries owed to their workers, social insurance, health insurance, unemployment insurance, unemployment subsidies, creating new jobs and training. In particular, Vietnam Development Bank will be responsible for giving these enterprises loans. Besides, Social Policy Bank will support workers at these enterprises …who were unemployed in 2010 and 2011 with loans using National Fund of the National

[83] Ibid.

[84] Nhat Nam, “VINASHIN has borrowed 292 billion VND at the interest rate of 0%,” *Vneconomy Newspaper*, February 16, 2012, http://vneconomy.vn/20120216065636449P0C5/vinashin-duoc-vay-hon-292-ty-dong-lai-suat-0.htm/, the original article is in Vietnamese.

Target Program on Employment …[as stated] in the Decision no. 157/2007/QĐ-TTg dated 27/9/2007 by the Prime Minister."[85]

All the above financial continuous support implies that the government still continues its backing up unsuccessful firms. Moreover, there have been always other SOEs who are ready to share the risk and the consequences of one SOE's inefficiency. In another word, there has been no single person who is responsible for the losses of VINASHIN. VINASHIN was set up by the government, using the government's financial resources. It borrowed more from other SOEs who are also using the government's financial resources. This explains why when VINASHIN faced to bankruptcy and its leaders had to admit to law court, its creditors stated that they did not want to get their loans back[86]. This is because they are managers of the loans, not the owners. This implies that as long as the state-owned assets are managed under administration system, there is no one responsible for the assets usage and protection. This even leads to the moral hazard in and among different SOEs.

Another point is thinking that close direction will lead to more effective operation, the government has assigned the MOT to supervise and evaluate closely all VINASHIN's objectives, master plan, organization and investment and report to the Prime Minister. However, line ministries are purely administrative agencies whose direction cannot guarantee firms' good investment in all cases. Furthermore, in the restructuring plan, although there are

[85] Nguyen Thang, "Prime Minister's decision to give loans at the interest rate of 0% to the enterprises who were moved from VINASHIN to VINALINES," *Bao Moi Newspaper*, December 29, 2010, http://www.baomoi.com/Quyet-dinh-cua-Thu-tuong-Chinh-phu-cho-Vinashin-vay-lai-xuat-0/47/5460704.epi, the original article is in Vietnamese.
[86] Thanh Phong, "Creditors do not want to get their loans back," *Thanh nien Newspaper*, http://www.thanhnien.com.vn/pages/20120330/du-doanh-nghiep-khong-doi-vien-van-bao-ve-tai-san-nha-nuoc.aspx, the original article is in Vietnamese.

efforts to make VINASHIN focus on its relevant areas and reduce debt, there is little information about the incentives to motivate the new leaders to operate VINASHIN efficiently.

The overall restructuring program showed that the government has been intervening even deeper into VINASHIN and making it more of an administrative agency than before. VINASHIN continues to receive support to practice its policy-practicing role as to maintain and develop the ship-building industry. The moral hazard happens when the leadership of SOEs could assume that it is safe if they make frequent reports to the line ministry so that the ministry can be responsible when the firm is inefficient. Again, this method endangers the future of VINASHIN. This is also consistent with the right hand side of the proposition (1) and rejects that of the proposition (2).

CHAPTER V: CONCLUSION

1. Doubled moral hazard due to the combination of government's support and heavy intervention into VINASHIN's management

The case of VINASHIN is consistent with the main hypothesis (proposition (1)). The case also rejects the alternative one (proposition (2)).

It is obvious that the government has tried to supervise, support and rescue VINASHIN with a desire to make the ship-building industry one of the driving forces of the whole economy. Considering the collapse of VINASHIN the failure of the industry, the government tried to rescue VINASHIN after insolvency. The burden of the debt created by VINASHIN was shared by other SOEs including PVN and VINALINES. More loans, new leadership and stricter supervision were the government's solutions to the situation. However, the government's financial backing and its heavy intervention lead to doubled moral hazard. This logic can be applied to other SOEs. Certainly, specific cases needs to be further studied.

First, the government created favorable conditions for VINASHIN including easy access to huge loans domestically and internationally together with little interruption by auditing plans. However, as VINASHIN's leaders had relied on the support and induced seriously risk-taking behavior, VINASHIN fell into huge debt.

At the same time, thinking that closer supervision and direction will help the firm to perform better, the government has intervened into VINASHIN's investment decisions frequently. Moreover, the government has tried to manage VINASHIN as an administrative office to realize the government's policies. However, VINASHIN had little motivation to make profit or save losses. In addition, the interest of the individuals managing the firm has not been linked to the firm's outcome. They tended to fulfill the tasks they are ordered. Therefore, opposite to the government's expectation, the firm has operated inefficiently while claiming that it has been simply following government's direction. Again, this sequence of the government and VINASHIN's risky behavior is consistent with the hypothesis explained in the proposition (1):

Financial Backing + Top-down Intervention = Careless Decision + Passive Management

This paradox happened again even after the firm's insolvency. Facing to the insolvency of VINASHIN, the government has tried again to bring VINASHIN back. Using the same method of providing loans, however, together with new leadership and supervision, the government hoped that VINASHIN would restructure successfully. Moreover, the government allowed VINASHIN to continue borrowing the revenue from bond issues and used various funds to support the employment status. Even though the government has changed the CEO of VINASHIN after its insolvency, there have been few incentives for the CEO to utilize his independence. The CEO of VINASHIN continues to realize the government's orders and has to follow orders closer. After insolvency, VINASHIN has been still in huge debt and shows little signals of improvement. This rejects proposition (2):

Capable Leadership + Financial Backing + Top- down Intervention = Careful Decision + Active Management

Moreover, the government's efforts in helping VINASHIN to restructure would have serious impact on other SOEs. This creates a stronger belief that the government will ever rescue SOEs which easily leads to more moral hazard in SOEs.

Besides, as analyzed in the previous chapter, the government considered VINASHIN ship-building industry. Providing VINASHIN with financial support has been always valued as maintaining and supporting the ship-building industry which has been proved to be an advantageous industry for Vietnam due to the country's long coastal line. Actually, the ship-building industry could be developed with other methods, not just providing financial support to one SOE, in this case, VINASHIN. Therefore, separated policies and incentives to develop ship-building industry must be established and based on the characteristics of this industry. This issue needs further study. In addition, when the method of providing financial resources did not guarantee VINASHIN's utmost efforts in production, it should not be used again in such as short period of time.

2. Implied reduction in the government's role in VINASHIN as well as other SOEs

Since the restructuring program, VINASHIN has not shown noticeable signs of improvement. It is time for the government to reconsider its role in VINASHIN. This can also be applied to other SOEs. However, how to apply to each particular SOE should be further studied. In details, based on the analyses of this case study, the reduction of the government's role can be achieved by the following ways:

[Reducing top-down orders]

VINASHIN could not at the same time realizes the government's policies and makes profit. Top-down orders have decided what VINASHIN had to invest into. Together with financial backing, it carelessly invested into the areas assigned. Therefore, VINASHIN should only focus in one objective as to operate profitably. When it becomes a strong enterprise, it could contribute to realize the government's policies.

[Creating more incentives for the leadership of VINASHIN]

VINASHIN has got a new leadership. However, the leadership of VINASHIN has been working as orders-practitioners. They have little chance to prove their capability. They have had to pay attention to work as closely to the task they are assigned as possible. Therefore they could not pay enough attention to running VINASHIN as a profitable ship-builder. There should be more incentives to motivate the people who are responsible for the development of the economic group. If the government's intervention is limited, the proposition (2) in the paper can change. Therefore, the right hand side of the proposition (2) has the possibility to happen. However, this needs further study.

[Reducing new loans for VINASHIN]

The government has been supporting VINASHIN after the restructuring program with new loans and lower interest to pay debt. VINASHIN has simply used new debt to pay old debt. However, this support is inefficient as VINASHIN has continued to ask for more loans, explaining that it needs more time to boost its production. The paper assumes that the new leadership is trying to operate VINASHIN with utmost efforts. However, with such huge debt and a number of on-progress projects, efforts are not enough. VINASHIN faced insolvency and it should go through normal debt-equity swap. The government should let an independent third party to work on VINASHIN's debt.

What is the most challenging problem is that as analyzed in the previous chapter, a number of creditors are actually other SOEs, the leaders of which do not have incentives to require VINASHIN to pay debt. This is serious to the whole country as there is no particular party who is responsible for this kind of debt. Instead of waiting these SOE-creditors to become more responsible, the government should also let an independent third party to work on the case.[87]

[87] This issue is quite challenging and should be further studied, especially when it may happen not only in VINASHIN but a number of other SOEs.

[Avoid rescuing all inefficient subsidiaries]

The government has moved a number of VINASHIN's subsidiaries to other SOEs. However, when a number of subsidiaries are also in debt and operate inefficiently, there are few evidences that they will become efficient when being moved to other SOEs. Debt and insolvency of these subsidiaries should also go through normal debt-equity swap process.

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