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Ministry of Finance



**Organisation for Economic Cooperation &
Development**

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Why Corporate Governance Matters for Vietnam

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Afternoon Session: The Role of Company Law in Improving Corporate Governance
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The Role Of The Law On Enterprises To The Establishment And Improvement Of Corporate Governance In Vietnam

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1. Corporate governance and the role of legal framework.

One of the accomplishments of development process for corporate management models is the separation between the owners and people who manage and use the owners' investment capital in manufacture and business of enterprises. However, it has created conflicts on targets between the owners and the managers. These conflicts have been known for a long time as the term "*principal-agent problem*". It means that a company is managed by professional agents, the managers can pursue their targets which differ from the owners' targets, even these targets are on the contrary to the interests of the owners.

So, many governmental agencies, organizations, enterprises ... have had much concern of the issue how to improve the corporate governance in recent times. Corporate governance, in a narrow scope of meaning, is understood to be a supervision or management mechanism of the owners to the managers under the owners' targets and strategies. For a larger scope of meaning, corporate governance is attached closely to interests of the owners as well as the creditors, the suppliers, the labours, even the customers of the enterprises. Corporate governance, in the organizational aspects, include relations between the owners, Board of Directors (BODs) and related objects in order to determine the targets, forming instruments to gain the targets and supervising the implementation process of these targets.

Ministerial Meeting of OECD has approved principles of corporate governance in 1999. This is the base for member countries considering and applying them in accordance with each member's circumstances. Five issues of principles are summarized as follows:

1. Corporate governance needs to ensure basic principles of the owners.
2. Corporate governance is required to set equal behaviours between the owners and to ensure the right compensated when the owners's rights are broken.
3. Corporate governance is needed to have respects of the owners' rights stipulated by laws and to encourage support for the cooperation between the owners and the enterprises due to a prosperous, strong and stable enterprise.
4. Corporate governance needs to have a mechanism, through which operation results, information on the owners and supervision is disclosed exactly and timely.
5. Corporate governance required to identify strategies as well as efficiently supervise on management of Board of Directors and explanation responsibilities of Board of Directors to the owners.

During the year 2004, OECD has declared new principles on corporate governance. They are including 5 ones mentioned by the year 1999 above (the remaining contents basically) and supplementing one more important principle (the first principle), that is: *“Corporate governance needs to be in conformity with legal documents; supporting the market transparently and efficiently; attaching closely to assigning responsibilities between supervising agencies, policy-making ones and policy-executing authorities”*.

This supplement principle, in one aspect, is the result of practical summarizing process a long with point of views from a number of countries (inside or outside OECD), international organizations, economic experts, even views on the Internet. In the other one, it has shown importance of legal rules and law execution in forming a corporate governance mechanism efficiently. On the other way, a rule on the best corporate governance must be in accordance with legal framework and vice – versa, good framework will have good influence on establishing and improving corporate governance.

2. The role of the Law on Enterprises in establishing corporate governance framework in Vietnam

The Law on Enterprises in Vietnam approved by National Assembly in 1999, putting in force from the year 2000, has stipulated 4 kinds of corporates, including limited companies, joint stock ones, joint fame ones and private ones. The 5 - year - law-execution, in practice, has been found that this is a good law for Vietnam’ economy, also for principles of market economy and common international standards.

The Law on Enterprises has had a number of rather clear and suitable regulations on the aspects of corporate governance. It has created legal framework to form an efficient corporate governance mechanism, especially for 2 kinds of modern corporates as joint stock companies and limited companies as follows:

a. Protection and encouragement for the owners’ legal rights

One of basic principles of a good corporate governance mechanism is to ensure the minimum rights of the owners. For this objective, the Law on Enterprises in Vietnam has stipulated clearly the minimum rights of the owners (shareholders in joint stock companies and members in limited ones) under the international corporate governance principles codes, including:

- Regulations on registration of the stocks holding rights for the owners;
- Rights of stocks/capital invested transferring
- Rights of receiving important information on the enterprise’s operation;
- Rights of participation and vote at shareholders Congress or members Meeting;
- Rights of election and dismissal for the members of Board of Directors (general director of limited enterprises);

- Rights of being shared the profits of the enterprises (dividends).

The law has also stipulated on ensuring the mechanism allowing the owners (through shareholders Congress/members Meeting) to participate in approving the amendment and supplement of enterprises' regulations – legal documents inside enterprises and the base to implement corporate governance mechanism as well as approving the permission of issuing new stocks/invested capital.

For the rights of participating in “the supreme made - decision agency” (Article 70), for example, joint – stock companies, current Law on Enterprises in Vietnam has made chances for shareholders to participate in enterprises truly and implement the voting right in shareholders Congress, shown as follows:

- Shareholders are provided information on how to organize the shareholders Congress including the voting procedure (Article 76, Article 77);
- Shareholders are provided information exactly on time, place and agenda of shareholders Congress (Article 74 of the Law stipulates that the person who summons shareholders Congress must invite all shareholders having the right of participation not later than 7 days before the opening day, a long with attached agenda, documents for approving the decision);
- Shareholders can direct or authorise others in document to take part in shareholders Congress. In case, shares are transferred from the time establishing shareholders list to the opening day of shareholders Congress, the person receiving the stock transfer has the right to participate in shareholders Congress in stead of person who has transferred the stock shares (Article 75).

Moreover, the Law has enabled the owners to take part in the process of making most important decisions of enterprises. For example, Article 70 stipulates specifically rights of shareholders Congress in joint-stock companies.

- The rights to decide all types of shares and total shares offered each; decide each share's dividends annually;
- The rights to elect, dismiss or revoke members of Board of Directors and supervising Board;
- The rights to review and settle faults of Board of Directors and supervising board which make a loss to shareholders and the enterprises;
- The rights to decide the restructure and liquidation of enterprises;
- The rights to decide amendment and supplement of regulations, excepting regulating capital charter by selling new shares within numbers of shares offered under enterprises' regulations;
- The rights to approve the financial statement annually;

- The rights to approve development strategy, decide to sell assets with value less or more than 50% total asset value recorded in accounting book of the enterprises;
- The rights to decide to repurchase more than 10% total shares each sold;

The rights of board of members are shown much more specifically and jurisdictionally stipulated in limited companies as follows:

- Decide enterprises' strategy development;
- Make a decision on increasing or reducing capital charter, on time and methods to raise more capital;
- Decide the investment method and investment projects with the capital more than 50% total assets value recorded in accounting book or other ratio less than stipulated at enterprises' regulations;
- Approve the loan or lending contract; selling assets with the value of equal or more than 50% total assets value recorded in accounting books of the enterprises or less ratio stipulated at regulations;
- Elect, dismiss or revoke the Chairman of Board of members; deciding election, dismissing general directors (managers), chief accountant and other key staffs stipulated at regulations;
- Decide salary and other interests for general directors (managers), chief accountant and other key staffs stipulated at regulations;
- Approve financial statements annually, capital using and profits distribution methods or loss settlement methods of enterprises;
- Decide organizational structures;
- Decide the establishment of branches, representative offices;
- Amend and supplement enterprises' regulations;
- Decide to restructure enterprises;
- Decide the enterprises' dissolution

b. Ensuring equal behaviors among the owners

A good corporate governance mechanism must ensure equal behaviors among the owners with the investment of the owners in different economic fields and social classes. For this aspect, the Law on Enterprises has shown specifically as follows:

First, the Law on Enterprises in Vietnam has stipulated the principle ensuring the equal behaviours among shareholders holding the same shares/capital invested. For example, joint stock companies, these principles have been clearly stipulated at the Article 53 (the rights of popular shareholders), Article 55 (voted preferred stocks and the rights of

voted preferred shareholders), Article 56 (dividend preferred stocks and the rights of dividend preferred shareholders) and Article 57 (returned preferred stocks and the rights of returned preferred shareholders). These regulations will enable the shareholders to receive information on the rights of each stocks before purchasing it.

Orders and procedures in shareholders Congress/members Meeting are also stipulated equally among all the owners. The Law does not have any stipulations creating too much difficulties or to high expenses for the owners' vote.

Relating to ensuring the rights of the minor owners, the Law has stipulated that shareholders or shareholders group who owns 10% popular shares have the rights of nominating someone in Board of Directors and supervision Board, of a request to summon the shareholders Congress as watching and receiving a copy or a index of shareholders list who have the rights to take part in the shareholders Congress; of requesting the agenda. The Law has also shown the rights for the minor members of the limited companies (representative for 35% capital invested).

With the target of protecting the minor shareholders, escaping from personal interests of members of Board of Directors (normally big shareholders), the Law has stipulated that if the value of economic or civil contracts between the company and the members of Board of Directors, shareholders owning more than 10% voted preferred stocks, their related people is more than 20% total assets value recorded in accounting books of the company, sides are allowed to sign the contracts when shareholders Congress has approved. If not, these contracts are invalid and settled under the regulations. People must compensate damages made by them to their companies.

c. Information disclosure and transparency of the corporate governance mechanism.

First of all, in relation to the third partner, the Law has clearly stipulated during the specific schedule from the day ending fiscal year. Accordingly, joint – stock companies/limited ones must send their annual reports approved by shareholders Congress/member Meeting to tax – collecting agencies and registration ones. In addition, every organizations and individuals are allowed to see and copy annual financial statements of the company at the registration agency, paying the fees. Financial statement has been carried out under the regulations, but normally consisting of most important aspects of capital such as equity, loans, costs, income, profit or assets ..etc.

For the joint – stock companies audited under the regulations, their annual financial statements must be determined by an independent auditing company before being submitted to shareholders congress to consider and approve.

In addition, key issues relating to the corporate governance mechanism have also been transparent with the state administration agencies (for required objects) through enterprises' regulations. The Law has stipulated that issues in enterprises' regulations must be consisted of:

- Name, address of enterprises, branches or representative offices;

- Objectives and business fields and charter capital;
- Shareholders/ establishing members; rights and obligations of the owners;
- Shares/ invested capital, distribution, share prices/invested capital;
- Organizational structure, legal representative;
- Method of approving decisions and principles of settling internal disputes
- The cases the owners can request the companies repurchase their shares/invested capital;
- All kinds of funds and limitation of each fund;
- Cases for liquidation, liquidation orders and asset liquidated procedures
- Method of amending and supplementing regulations

The creation of legal documents to publicize information and the corporate governance mechanism as stipulated under the Law mentioned above is one of important solutions in order to help partners, customers and potential investors (especially strategic investors) in approaching accurate information sources of their next decisions in accordance with enterprises' relations.

d. Board of Directors and BODs supervising mechanism of the owners in the corporate governance mechanism

Followed by the international corporate governance rules, Board of Directors must act as the representative of the owners' interests in enterprises' operation. In order to act the most basic function as above, Board of Directors need to have rights of deciding strategies, key action plans, annual budgets and business plan; supervising administrative structure; of selecting, appointing, dismissing, supervising results and deciding salary for executives...

Almost above requirements have been mentioned in the Law on Enterprises in Vietnam. Accordingly, the BODs have the rights:

- Decide development strategies of the enterprises;
- Propose types of shares and total ordered shares of each;
- Decide to offer new shares in a scope of shares ordered each; deciding to raise capital in the other method
- Decide investment methods, market development solutions, marketing and technology; approving buying/selling contracts, loans, lending contracts and others with the value of the same or more than 50% total assets value recorded in enterprises' accounting books or other ratio less than stipulated ratios in regulations.

- Appoint, dismissing, revoking Directors (general directors) and key management staffs; deciding their salary and other interests
- Decide organizational structures, internal management regulations, small belonging companies, branches, representative offices and invested capital, bought shares of other companies.
- Submitting annual financial reports examined to shareholders Congress;
- Request dividends, time and procedures to pay dividends or loss settlement happening in their operation process;
- Decide ordered price for companies' shares and bonds; evaluating assets invested, not money in VND, free transferable foreign currency, gold;
- Approve programmes, documents for shareholders Congress Meeting; summoning the shareholders Congress Meeting or preparing procedures making questions in order to help shareholders Congress to approve decisions.
- Decide to repurchase not more than 10% shares sold by each kind.
- Propose restructure or liquidation of the company

Along with operation functions, obligations are stipulation on BODs operation mechanism, including BODs meetings, principles of resolution approval, dismissed or added members of BODs.

In order to manage functions, obligations efficiently, the Law has stipulated on the rights being provided information of members of BODs. Members of BODs are allowed to require managers, general directors, vice directors and other management staff to provide information, documents on financial situation, business operation and units belonging to the company. Management staff are required to supply information, documents accurately, timely by BODs.

Accordingly, the Law has also stipulated in details on responsibilities of BODs. Members of BODs must execute the rights and obligations truly because of enterprises' interests and shareholders. They can not depend on their positions to make personal interests and use assets of the enterprises for another people.

For the two or more than two – member – limited companies, the Law on Enterprises can not stipulate on model for BODs. But for one – member – limited company, BODs have also the same functions, responsibilities and obligations as above enabling operation under corporate governance efficiently.

3. Shortcomings and some solutions to improve corporate governance under the Law on Enterprises.

Although the Law on Enterprises has been seen to cover all contents in accordance with principles of market economy and criteria of international rules in general, it has still shortcomings need amended, supplemented in the next time to strengthen and improve corporate governance under international standards. Some examples on shortcomings to joint – stock companies as follows:

Ensurance of the rights of shareholders, especially minor shareholders:

- Shareholders have been received important information but can not be allowed to approach all information, documents, files of enterprises. They do not ensure the rights of seeing accounting books, minutes of BODs Meetings or shareholders Congress.
- Though ensuring the rights for minor shareholders in nominating members taking part in board of directors, supervising board and for summoning shareholders Congress, the Law has not stipulated either the principles to determine numbers of people nominated or contents and forms on summoning requirement for shareholders Congress. As a result, these rights have been not executed efficiently in practice. Similarly, the rights of minor foreign shareholders have not been mentioned.
- The Law on Enterprises and relating legal documents have not had efficient stipulations for shareholders protection being seriously committed as well as a compensation method when the minimum rights of shareholders are committed. This is one of important issues proposed by OECD on the corporate governance rules.

Organizational structure for corporate governance

- The Law on Enterprises has not mentioned specifically on the owners authority. For the big joint – stock companies or joint stock companies with state's capital invested (from SOEs equitization), practically the person who directly implement the shareholders' rights is not the shareholder, only the representative. The representative is managed or supervised strictly by shareholders but may also not, leading to the issues the person authorized gets abuse on personal objectives. The Law on Enterprises has not covered this circumstance.
- Corporate governance in joint stock companies with majority capital of state usually has disputes. As a result, state administration agencies usually interfere on them. However, the current Law on Enterprises has not covered this issue.
- The Law on Enterprises has stipulated that shareholders Congress can approve decisions by getting shareholders' point of views in writing documents. It is a good regulation, especially for equitized companies with numbers of shareholders in many territories. However, execution mechanism has not been stipulated clearly. So, it is difficult to apply it in practice.

- The Law on Enterprises has not mentioned to criteria of members of BODs. It is suitable for joint stocks companies in private sectors in practice of Vietnam. However, there are a lot of uncontrolled issues for big joint stock companies, joint stock one with foreign partners or state's investment capital.
- The summoning mechanism of BODs meetings is also a concerned issue. Relating to regulations of BODs, beside Chairman, no ones are allowed to have the rights to summon the BODs meeting (understood that chairman of BODs is the unique person to carry out this function). So, much disputed joint stock companies in practice in recent times have been seen that popularly Chairman of BODs has postponed or cancelled summoning BOD meeting even when being required by others members. The potential consequences are that members do not have the same points of views of Chairman, so they can not fulfil their obligations and responsibilities under the law, resulting in bad influence on corporate governance. In case, the Chairman acting as the legal representative as well, the functions of BODs have not been ensured.

Moreover, the current Law on Enterprises has not mentioned to the corporate governance mechanism of state – owned – enterprises and foreign investment enterprises under the forms of joint stock companies and limited ones. For the intention of building a common legal framework covering all kinds of corporates, so, foreign investment and state – owned – enterprises' corporate governance mechanism must be mentioned by the Law, especially SOEs because international experiences as well as Vietnam's practice have shown that corporate governance of SOEs has still get shortcomings, differing from modern corporate governance rules.