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Reforming the Enterprise Law in a Culture of Gradualism Lessons from Vietnam

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Executive Summary:

To meet the economic growth goals of the country, Vietnam realized it had to embrace the reality of globalization. By leveraging outside experts and encouraging an active public-private dialogue, the Unified Enterprise Law was drafted and enacted. The law has helped to level the playing field for domestic and foreign investors. As well, the process provides many lessons for future legal reform.

Introduction

Vietnam has been one of the most dynamic economies over the last 20 years. Much of the fervor can be attributed to the government's willingness to make the necessary reforms to loosen the constraints of a cumbersome business environment. Vietnam's first Company Law, enacted in the 1990s and based on a very simple framework, officially permitted private ownership of enterprises for the first time. In 2000, the Enterprise Law (EL) regularized business registrations, eliminating the discretion of local officials and providing some investor protection. To capitalize on these successes, however limited, Vietnam enacted a new Unified Enterprise Law (UEL), effective July 2006. This law extends equal protection to foreign and domestic enterprises. This reform demonstrates the importance of the context within which the reform takes place and the support of internal and external stakeholders to shepherd the reform through the process. It also highlights the reality that once the law is drafted, much hard work remains to be done.

Context

Central Government Embraces the Reform Agenda

The original catalyst for Vietnam's commitment to rule of law as a basis for moving to a socialist market economy was the Vietnamese Party Congress of 1986. The policy of doi

moi (change and renewal) was a response to economic slowdown and elevated the private sector as the engine of future growth. Government commitment to market reforms has intensified over the last 20 years and particularly since 2000 in response to several domestic drivers. First, with a growing and youthful population, the economy needs to accommodate an entering workforce of 1.5 million annually. Coupled with the need for capital and infrastructure, strengthening investor protection is essential to new job creation. Second, to support market-oriented reforms, the Vietnamese Communist Party's embrace of rule of law is also driven by a desire to maintain the party as the center of the state and enhance its legitimacy. Third, Vietnam's socialist-market economy is growing strongly but remains segmented, with SOEs, foreign-invested enterprises, and small and medium-sized enterprises (SMEs) occupying very distinct tiers. These varied enterprises share two common challenges—shortages of land and shortages of capital. The new UEL's framework of improved investor protection provisions is a crucial element in laying the groundwork for a functioning securities market through which investment capital can be solicited.

To meet its planned 2006–2010 GDP growth rate of 7.5 percent to 8 percent per annum, the government recognized that it must in-



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tegrate its economy globally. Unfettered access to world markets became a priority, leading the government to pursue multilateral and bilateral trade negotiations with major trade partners. After signing and implementing its bilateral trade agreement (BTA) with the United States, exports to the United States grew 500 percent. Vietnam now had the confirmation that it was ready to compete in world markets—a sense that had not been strong five years ago. Vietnam’s application to join the World Trade Organization (WTO) was a key driver for reform. The accession process requires that laws and legal institutions be transparent, rule-based, and neutral in their application to domestic and foreign business. The requirements also include reforms for investors, such as the publication of laws and regulations; market access to new business and service sectors; the introduction of intellectual property protection; and enhancements to the courts. In the wake of multilateral and bilateral trade agreements, intense pressure on the government has helped drive reform to create a level playing field for businesses, domestic and foreign, state and private, and large and small. Party guidelines call for the “creation of a favorable and equitable legal environment for businesses to compete and cooperate to develop” and “substantial reduction and moving towards eliminating the discrimination in terms of policies and laws on domestic and foreign investment.”

Approach

Engaging Outside Experts

The UEL originated at the government level as part of a multiyear reform effort; however, international support and input has been critical. Donors have provided key assistance and guidance with drafting and implementation. It often falls to these external experts, who are knowledgeable about a wider range of Vietnam’s laws, to try to ensure consistency among laws. The USAID STAR project, viewed as a success, was designed to provide technical support for legislative drafting in preparation for Vietnam’s entry into the previously mentioned BTA. STAR provided drafting assistance and detailed analysis on over 43 Vietnamese laws. A key component of the project’s success was its ability to hire talented Vietnamese staff who are well connected to government and provide unique access to key political personnel through their relationships (e.g., former classmates).

Champions and Naysayers

Every government ministry and agency in Vietnam has pro- and anti-reform actors. Frequently the bureaucrats favoring reform are younger and foreign educated. Within government, not surprisingly the Ministry of Trade has, at times, functioned as a drag on liberalization. Opening markets and complying with requirements of new trade agreements directly impacted the ministry’s jurisdiction over domestic businesses and its control over business licenses, a lucrative revenue source for officials at the local level. Their desire to keep “distribution businesses” outside the uniform regulation of corporations under both the EL and the UEL exemplifies this “turf protection.” Top-level ministry officials knew full well the requirements to deregulate and open markets that flowed from BTA and WTO commitments. Ultimately this battle was resolved at a higher level of government.

Public-private Dialogue

A key component in Vietnamese enterprise legal reform has been the expanded use of public-private dialogue, supported by donor funding. Three institutions have played a particularly active role. First, the Vietnam Chamber of Commerce and Industry (VCCI), a primary facilitator for business-oriented reforms participated on the drafting committee of both the EL and the UEL. VCCI’s website publishes business-related laws, solicits opinions, and facilitates discussion. During the UEL drafting process, VCCI ran conferences that attracted nearly 1 million participants.

Second, the Vietnam Business Forum (VBF), created by donors in conjunction with the Ministry of Planning and Investment, has also served an important role to facilitate dialogue between donors, the private business community, and government leaders. Held the day before the regular session of the National Assembly, it gives business representatives direct access to the prime minister and key policy makers shortly before they are to consider pending legislation. The VBF also publishes position papers and comments on current legislative drafts. Third, the Mekong Project Development Facility, a multidonor-funded project managed by International Finance Corporation, undertakes research and policy dialogue to improve the business environment for SMEs.

In addition, the media has begun to play a key role in engaging stakeholders, promoting good corporate governance, and educating people

about shareholder rights, especially at the local level. Vietnam has a television program dedicated to legal matters where attorneys and government officials publicize new laws. Newspapers also play a similar role. In VCCI's business law workshops, up to 20 percent of attendees are journalists.

Results

The Substance of the New Law

With the passage of the UEL, minority shareholders and investors now enjoy enhanced protection in several ways. First, all now have greater access to shareholder and corporate records; annual meeting requirements are specified; proxies are permitted; cumulative voting is mandated; and last, it is now required to have at least 65 percent of total voting shares for shareholders' meetings and 75 percent for certain significant actions. Second, shareholders, or shareholder groups, holding more than 10 percent of the total ordinary shares can now:

- Review corporate records and financial reports;
- Make requests to the Board of Supervision to examine management and operational problems;
- Convene shareholders meetings if the Board of Management seriously violates the rights of shareholders, duties of managers, or makes decisions beyond its power; and
- Compel a new Board of Management election if its term has expired by more than six months.

Shareholders are now individually liable if they act on behalf of the company to violate the law, conduct business for self-profit, or pay off undue debts when there is a financial danger facing the company; corporate insiders are personally liable for certain actions; ordinary shareholders have preemptive rights when additional ordinary shares are issued; a new Board of Supervision was created for companies meeting certain thresholds; and disclosure of holdings in other companies by the Board of Management, director/general director, and other managers is now mandated. By increasing the protection of investors in the law, policy makers expect to see increased investment in the country.

Challenges Ahead

Even in Vietnam, where there has been widespread support in principle for strengthened corporate governance and investor protection, implementation is likely to be a long process. SOEs are likely

to view the UEL's corporate governance rules as a significant and unwelcome change to their entrenched centralized power structure. Ministry officials recognize that Vietnam needs to educate a pool of professional managers, particularly for SOEs, who are market oriented rather than politically motivated and are willing to accept corporate governance reforms, even if they do not embrace them. No resources have been allocated for this training. It is doubtful that the necessary systemic and mind-set changes can be accomplished in the four-year time frame envisioned by the UEL.

Transparency is a relatively new concept in Vietnam. Traditionally, the Vietnamese have relied on relationships more than external laws; companies have been built around family ties and personal relationships, not formal disclosure. This has in part been driven by a fear of inspections, especially tax inspections, and the resulting fees. Even after enactment of the EL in 2000, the vast majority of smaller businesses did not register. It is unlikely that the UEL will change the way small businesses conduct themselves. Although Vietnamese business associations are starting to promote ethics and codes of conduct, corporate governance is generally viewed as a low priority by most business people.

Although the UEL is a national law, business registrations and most licensing occur at the local level, which often creates disparate results. Omissions or uncertainty in the law not addressed in the implementing decrees fall to local officials to resolve. Few local actions are transparent, creating opportunities for corruption. The central government supports these new laws as a device for regulating local politicians and maintaining control. However, it remains a challenge for the central government to manage opposition from local bureaucrats who depart from policy to further local interests.

Vietnam's investor protection laws do not contain sufficient enforcement mechanisms. Most disputes are still solved informally with negotiation; i.e., if a minority shareholder cannot negotiate a satisfactory outcome, he is more likely to sell his shares and terminate the relationship than seek relief in court ("exit" rather than "voice"). Other extralegal measures include the threat of publicizing a dispute, which is often sufficient to spur resolution, or resorting to self-help measures such as taking physical custody of the company seal. Claims may also be asserted

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The urgent need for reform in a culture of gradualism

A key characteristic of doi moi has been a preference for stability over rapid change. Careful planning by the Vietnamese Communist Party continues to characterize regulatory change in Vietnam. Even where views have conflicted about the pace or content of reform, all legal reforms implemented since 1986 have had Party authorization and have been extensively debated and scrutinized by the Party's Internal Affairs Committee.

The acceleration of commercial legal reforms since 2000 is consistent with this stance. Donor funding from UNDP, Sweden, the United States, Canada, and elsewhere produced a series of "blueprint" documents on legal reform for Vietnam, including the Legal Reform Strategy for implementation by 2020 and the Judicial Reform Strategy. These are being implemented gradually, in part because the Party historically regarded the judiciary as a Party organ and thus did not develop its capacity for independent growth and decision making.

About BizCLIR:

BizCLIR, or the Business Climate Legal & Institutional Reform Project, is a multi-year initiative of the United States Agency for International Development with the goal of improving the efficiency and impact of assistance programs intended to help developing countries improve their business enabling environments. This series, Best Practices for the Business Environment, represents one of many knowledge management components of the BizCLIR project. The goal of the series is to highlight the known best practices, case studies, lessons learned, and in some cases worst practices, so that the lessons can benefit other practitioners in the field. All issues are available at www.bizclir.com.

through administrative channels, including the local registrar, provincial officials, or the People's Committee. Although many Vietnamese still associate courts with criminal activity rather than civil dispute resolution, courts are playing an increasing role in resolving corporate conflicts.

Few judges are versed in commercial law, fewer yet in corporate governance. There is still no systematic national publication of court decisions. Judges may be easily influenced by the stronger party. All decisions may be appealed, which is a common delaying tactic. There is significant case backlog, as many as 80,000 pending cases in the Hanoi court system alone. The actual enforcement process is time-consuming and expensive, and the outcome is uncertain.

Conclusions

From the experience of drafting a new UEL in Vietnam, 10 lessons stand out.

- *Political will is indispensable.* The government and the party embraced rule of law as a way of legitimizing their political control by advancing the economy.
- Trade negotiations are accelerators. Investor protection in Vietnam was ratcheted up and accelerated by trade negotiation timetables for bilateral agreements and WTO accession.
- *Donor program quality is important.* Vietnam has benefited from a concentration of donor expertise in the country. Donors have made significant direct (e.g., STAR) and indirect (e.g., the Vietnamese Competitive Initiative) contributions to the government's reform agenda, especially since 2000. Long-term commitments with strong personnel enable donors to establish key relationships and develop institutional knowledge, making them more efficient and effective in their reform efforts.
- *Donor coordination is essential.* Competition between donors has resulted in some waste, but it has raised the bar for the quality of input on market-oriented reforms. The success of STAR, for example, prompted other donors to extend SME support and other private sector programs.
- *Economic growth is a powerful motivator.* Vietnam has enjoyed sustained economic growth for several years and has weathered the Asian economic downturn better than most other countries. This strengthened the government's political resolve to continue with further, more radical economic reforms.
- *Success breeds success.* The success of the 2000 EL was reflected in the surge of enterprise registrations, especially among SMEs, which the government perceived as a signal that domestic enterprises were willing to adopt more formal structures and that the market was ready for further change. This enabled the government to create level-playing-field reforms for foreign and domestic investors and further regulate businesses through the reforms in the UEL.
- *Legal reform blueprints can be substantive.* The government has been highly selective about the legal reforms it has undertaken. To support the centralized market economy, the government commissions long-range reports (5 years, 10 years, 15 years) become a blueprint for reform. These blueprints enable the government to choose between reforms to suit its purpose when it believes the market is ready to sustain the reform. This range of choices also permits the government to upgrade reforms over time, as seen in the evolution from the Company Law to the EL to the UEL.
- *The role of technology is vital.* Vietnam's technology infrastructure has been a key factor in improved transparency and stakeholder involvement in the reform process. From websites that publish draft legislation and permit anonymous comments to television programs that publicize laws to databases of publicly accessible information, the past five years have seen a major improvement in the public's role in the reform process, facilitated by technology.
- *Growth deflects dissent.* Opposition to reforms comes from within the party, from within the government, and from local and provincial offices. The government must manage internal dissent by staggering reforms to coincide with economic growth periods. Dissent will continue to remain a problem, especially from localities where growth is uneven.
- *Quality of foreign investors is relevant.* Foreign investors, especially foreign law firms, have played a significant role in the legal reform process. Several international firms established a presence in Vietnam more than 10 years ago, and have provided a key service by publishing English translations of laws and, more recently, by acting as international legal experts in commenting on draft legislation.

