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The Impact of Equitization on Firm Performance: The Case of Vietnam

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Abstract

Privatization has been implemented across the globe as a pill to cure the weakness and inefficiency of state-owned firms. Numerous studies have conducted tests in a bid to examine whether privatization can help improve firm performance. The findings so far are inconclusive, with some indicating a significant benefit for firms in terms of efficiency gain and some arguing that privatization is a worthless economic reform. The equitization (known as partial privatization in other countries) has been part of Vietnamese economic reform since 1992, and is well-nurtured into the short-term future, at least. This paper characterizes the equitization of state-owned firms in Vietnam, and its impact on the stock market and firm performance. Our findings show that the equitization has several merits towards the stock market development, and that firms with state origin have better earnings, profitability and total asset turnover, compared to other firms. However, state-owned firms are valued lower in terms of market value.

Keywords: IPO, firm performance, privatization
JEL Classification: G34

1. Introduction

Facilitating the stock market growth is often cited as one of the main justifications for the privatization program of state-owned enterprises. Privatization scheme aids in the supply of goods for stock markets, and help diversify investment risks (Naceur et al., 2010; Draho, 2004). Besides, in many developing countries, the largest firms on the exchanges are often state-owned firms that have been privatized such as Petrobas (Brazil), ChinaMobile (China) or Telefonos de Mexico (Mexico).

Privatization helps attract investors through providing diversification opportunity for investors since now they have more goods to choose from. Moreover, stocks are issued at discount to attract more individual investors who do not have much access to information regarding firm's prospects and current conditions. Thirdly, privatization that comes with listing internationally increases domestic liquidity, through lowering the information barrier towards foreign investors. Even for the stocks that are only domestically listed after privatization, when foreign investors are engaged, domestic liquidity does benefit, thus pushing the market growth (Chiesa and Nicodano, 2003).

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Widespread privatization has generated a great concern and a large empirical literature regarding the influence of ownership on firm performance. Most studies find the beneficial effect of ownership on firm's profitability and efficiency (see Meggingson and Netter (2001)). However, the mainstream studies mostly focus on privatization that involves a majority of assets being sold and control rights being transferred from the government to private owners. Little research has been done about the influence of partial privatization (commonly called equitization in Vietnam) where the state remains the controlling shareholder after the privatization. This paper aims to contribute to the literature by investigating whether the firms's performance is affected as state ownership is partially divested. Analyzing the impact of partial privatization is critical for most privatization transactions are done partially (Gupta, 2012, Jones et al., 1999) and for theoretical interests (Gupta, 2012).

2. Previous Studies

Substituting public ownership with private ownership has been associated with several advantages to firms. From theoretical aspect, privatization can help raise the efficiency due to enhancement in the alignment of decision rights (Graham and Prosser, 1991; Boycko et al., 1996), which is consistent with agency theory (Dharwadkar et al. 2000). Nonetheless, many of changes in management could have happened prior to the privatization, for example firms can arrange several operations to cut off redundant labour and perform earnings management that shoot earnings upwards to superfluously attract investors. Afterwards, the performance of firms tend to reverse back to their previous performance which is much worse than what was shown in the reported statements before privatization. Megginson and Netter (2001) theoretically show the relevance of changes in internal process of companies that are expecting privatization (more likely to apply pro-efficiency policies). The political view of privatization has been studied extensively as well. Roland (2000) studies the issue of soft budget constraint that is much likely to be attached to SOEs, while Biais and Perotti (2002) emphasize the issue of commitment and voting.

Empirically, La Porta et al. (2002) investigate the impact of state ownership of banks in 92 economies, and show that large state ownership hinders the development of financial system and economic growth. This effect is mainly due to the negative impact of state ownership on productivity. Omran (2007) studies a sample of 12 Egyptian banks from 1996-1999, the time when the control was handed over from the state to private investors. The findings indicate the performance of privatized banks are better than those with major state ownership, but still inferior than other banks with other ownership compositions. Yet, this study suggests evidence supporting that banks with greater private ownership tend to performance better.

Some studies show the improvement in the performance of non-financial firms after privatization. La Porta et al. (1999) examine the performance of 218 Mexican companies privatized in 1992, and document the increases in output and operating efficiency while noting a decrease in total employment.

Mathur and Banchuenvijit (2007) study the changes in the performance of firms privatized through public share offerings from 1993 – 2003 internationally. The findings suggest increases in profitability, capital expenditures, output, dividend payouts and operating efficiency and a decreases in leverage and employment. The authors argue in favor of the beneficial effect of privatization on firm performance after including several important controls regarding the country, industry and business environment in which those companies operate. Wallseten (2000) (cited in Kim and Chung (2007)) studies firm performance from 1984 to 1997 using data of firms in 30 African and Latin American economies. The author concludes that privatization does not help increase the efficiency in itself, and can only work with effective and independent regulations. Also, Klein and Luu (2003) find that the success of privatization is not the product of the privatization itself, but also the perception of market participants and investors in terms of macroeconomic policies and how stable those policies will remain.

Okten and Arin (2003) studies the efficiency of 22 privatized cement factories in Turkey from 1983-1999 using pre and post-privatization data for all those firms. Okten and Arin argue that ownership effects are the main explanations for the increase in labor productivity. Yet, the results regarding the allocative efficiency is dependent on the competitive environment in which the firms operate. Finally, it is obvious that all plants garner better results in terms of labour productivity, but plants that are sold to foreign investors enjoy higher increase in capital and investment efficiency.

Kim and Chung (2007) claim that SOE sector underperforms private counterpart, and the Korean government was under pressure to solve and enhance SOE's performances. Kim and Chung compare the performance of 22 Korean SOEs in periods of high and low pressures of performance improvement during 1998-2002. The authors find that there is a positive link between privatization pressure and SOEs' operating efficiency. The authors claim that the regulators besides actually privatizing SOEs can also introduce tremendously privatization pressures to impose hard budget constraints, which can improve firm performance eventually.

Hagemejer et al (2014) propose a new approach in order to tackle the endogeneity. The result from the application of this method to a sample of medium and large Polish firms from 1995-2009. However, unlike most previous studies, Hagemejer et al (2014) find that firm performance hardly improve after privatization, after addressing the endogeneity problem. This suggests that the endogeneity bias cannot be ignored in research regarding firm performance and privatization, at least in the Polish context.

In Vietnam, Tran (2004) studies a sample of 450 privatized firms, especially the effect of managerial replacements and the effect of state ownership on firm performance from 2002-2004. Employing various measures of enterprise performance and controlling for pre-privatization-conditions as well as industry effects, Tran finds that privatized firms' performance is negatively affected by the remaining state ownership, and positively related to the deployment of new managers.

Truong et al. (2007) examines the impact of equitization on firm performance in Vietnam using a sample of 147 equitized firms and 92 SOEs. The findings show that there is a significant increase in profitability, operating efficiency, real sales and employee income following equitization. Also, the authors document an increase, not decrease, in employment and a reduction in leverage for equitized firms post-equitization period. The authors also find that size, ownership and the corporate governance have significant impact on changes of several performance indicators. Being listed has a negatively significant impact on profitability, but positively associated with real sales and sales efficiency. Finally, firms located in Hochiminh City have the most significant improvements in performance in comparison with firms from other regions in Vietnam.

3. Research Objectives and Methodology

This study aims to provide some insight into the impact of equitization in Vietnam on firm performance. The performance is examined using multiple indicators, namely Market to Book (MTB), ROE, ROA… The study employs two strategies to identify the influence of equitization. First, equitized SOE firms are compared with private firms. Second, we examine the impact of the state ownership on firm performance using the fixed effects estimator for panel dataset.

4. Background of Vietnamese Equitization

The equitization of state-owned enterprises in Vietnam is the process in which state ownership is transferred to other stakeholders. Unlike privatization, the government still keeps significant ownership in the equitized firms. This process is to transform the SOEs and to make them more efficient. The equitization process in Vietnam can be divided into phases as follows. First, from 1990 up to 1996, some small and medium-sized SOEs were selected to be transformed to a public company (pilot phase). In this phase, the highest proportion of shares that was owned by outsiders is just 35%. The pilot phase was extended into 1997, where the central government empowered local authorities to be more autonomous in conducting privatization deals for firms that have registered capital smaller than 10 billion VND. The next phase was from 1998-2001, in which the equitization was boosted and the proportions of stock that individuals and institutions could own would depend only on whether the state would prefer to get hold of the firm or not.

From 2002 to 2008, equitization entered a mass implementation. Methods of equitization include selling part of state ownership, selling all state ownership, keeping state's equity capital and selling more stocks to outsiders. The main method of equitization for firms with capital larger than 10 billion VND was auction, which helped shoot stock price of previously state-owned firms and brought large cash flows for the government. However, from 2009 to recently the equitization process has been slowing down since the remaining firms are corporations of large scale so vigilant examination of firm value is a prerequisite. Besides, the macro-economic context is not favorable for large-scale auction (Duong, 2015). In the future of equitization, the government still promotes its image as a pro-equitization authority and puts all of its effort into finalizing policies and infrastructure to boost state capital withdrawal. Especially, the equitization commission has been preparing a list of types of firms that the state should keep or withdraw its capital, so that the equitization process can finally be applied to all firms.

The demand for restructuring for state-owned enterprises stems from the fact that this type of firms requires more resources while generating less desirable outcomes compared to other firm types. Recently, another driving force for the restructuring is the requirement to abide by the bi- and multi-lateral agreements, especially TPP and ASEAN Economic Community, which aim to remove the trade barriers and privileges dedicated for state-owned enterprises. Besides, equitization in Vietnam is supposedly thought to have been promoting the growth of the stock markets effectively.

The below table gives details about the size and proportions of state-owned enterprises that have been equitized in Vietnam. In 2014 firms with major shareholder being the state accounts for 22% of the number of listed firms, but their size is 48% of the total market capitalization, for equitized state-owned firms in general are larger than other firms.

Table 1: The proportions of state-owned enterprises in Vietnamese stock markets

Year	Equitized SOEs	Listed firms	Prct of total firms (%)	Prct of total market cap (%)
2006	85	318	27%	37%
2007	103	414	25%	35%
2008	134	540	25%	45%
2009	142	599	24%	39%
2010	144	615	23%	32%
2011	151	666	23%	39%
2012	156	695	22%	46%
2013	155	718	22%	52%
2014	156	721	22%	48%
2015				Circa 64 %[2]

Source: Thomson Reuters.

Equitization in Vietnam has spurred the development of capital market, especially the stock market. The majority of the listed firms are those once state-owned enterprises that were equitized. Furthermore, the operating efficiency is upgraded, and corporate governance is modernized. Besides, being listed could also help improve the transparency, autonomy and self-responsibility of firms and makes the firms subject to social surveillance for their operating activities. This has consolidated the confidence in the investors, both domestically and internationally.

[2] Government's report no. 436/BC-CP, dated 17/10/2016

State-owned enterprises after being listed can summon investor interest, both domestically and internationally, thanks to their high quality. The sales and profit proportions of equitized state-owned enterprises are pretty large in comparison with the average of the listed firms. According to a report of firms equitized in 2011-2015 period, the performance in 2015 was much better than the year before, specifically, chartered capital increases 72%; total assets 39%; equity 60%; sales 29%, earnings before tax 49%, and the labor income 33%.

The equitization of state-owned firms in large scale with public auction approach on stock exchanges has brought a large quantity of quality goods to the market. Consequently, the equitization has indeed expanded the scale of the market and attracted investors. In Vietnam in January 2016, among the top 10 largest firms in the exchanges, 6 are equitized state-owned firms, namely Vinamilk (VNM), Vietcombank (VCB), Vietnam Gas Group (GAS), Vietnam Joint Stock Commercial Bank for Industry and Trade (CTG), BIDV, Bao Viet Group (BVH). According to a report from Ministry of Finance, the preliminary stage of equitization has generated the prerequisite for the establishment of stock market and provided more than 50% of the goods for this market.

However, it is not that simple that as long as there is equitization/privatization, the stock market will grow. In Vietnam, after the equitization process, the state still holds rather large share of stocks of listed firms, rendering quite concentrated ownership structure. Almost all state-owned firms in post-equitization periods still have not distinguished between the ownership and management of the firms. This is manifested by the fact that managers of many equitized firms still work under the state influence with regard to managerial decisions (Gainsobrough, 2009). Therefore, the interests of the minority shareholders cannot be guaranteed.

The majority of strategic investors claim that the holding of less than 51% of stocks at state-owned firms makes them uncomfortable, and such limitations risk equitization being able to attract only domestic investors (Round-up conference of the restructuring process and plan for 2016-2020). The typical case for this is Vietcombank: from 2007-2011, the state held 90.72% of capital. From 2012-2014, as the strategic partner, Mizuho Bank, shouldered 15% of the capital, the state ownership fell to 77.1%. So, even though the firm has largest market value, the real transaction volume of VCB stocks is rather small, and not contributing much to the liquidity or the facelift of transaction scale of Vietnamese stock market.

In addition to that, as we compare the number of listed firms on stock exchanges to that of equitized firms, there is a huge difference and the number of firms that actually listed after equitization is not high even many of them meet the listing criteria. Therefore the potential of expanding stock markets is high if all the firms that are eligible for listing are forced to go through listing process. The impact of equitization on the growth of stock markets can be more pronounced if done transparently and the information is disseminated equally and in full to the relevant stakeholders.

5. Empirical Comparison between Equitized Enterprises and Private Enterprises

Our empirical strategy is to investigate whether the operating performance of firms depends on the equitization of state-owned firms. To compare the differences among various indicators of firm performance, the authors collect data related to ownership of firms that have been listed. Table 2 shows that both the equitized firms and the private firms perform similarly in term of market to book ratio (MTB) and return on assets (ROA), but the equitized firms perform better in term of ROE, mainly due to the use of higher leverage. The equitized firms have higher leverages because they have easier access to the bank loan. In fact, state owned banks in Vietnam are more willing to lend to the state-owned firms because the banks will receive less penalty in case the state firms fail to repay the loan. Traditionally state-owned firms hold key position in the industry therefore the equitized firms tend to be larger than the counterparts.

Table 2: Characteristics of firms (t-test)

	Equitized SOE			**Private firms**			**Difference**		**Sig.**
	Mean	**Median**	**obs**	**Mean**	**Median**	**obs**	**Mean diff.**	**t**	**P-val**
MTB	1.08	0.81	849	1.07	0.81	2536	0.02	0.4	0.37
ROE	14.89	13.48	1064	13.68	13.38	3172	1.21	1.82	0.08
ROA	8.77	7.66	1073	8.54	7.49	3247	0.23	0.73	0.3
DEBT_EQUITY	86.98	46.62	1166	81.02	46.44	3566	5.97	1.64	0.1
MARKETCAP	2.24E+09	2.06E+08	1021	9.99E+08	1.57E+08	2981	1.24E+09	5.44	0

Source: Thomson Reuters. Calculated by authors

To investigate the impact of state ownership on firm value, we control for size, leverage and momentum (see Table 3). The coefficient of state ownership variable is negative and significant, implying that the higher state ownership, the lower the market value. This suggests that investors do not appreciate firms that have a high state ownership because the state owners usually have various mandates and do not always seek to maximize the shareholders' value. Given the size of state ownership in the equitized firms listed on Vietnamese stock exchanges, if the State sold all of its ownership, then the market value of all the equitized firms would increase by VND 44,000 billion (equivalent to USD 2 billion)

As STATE variable is significantly positive, it indicates that firms with the state origin tend to have a higher value than other firms. It does not necessarily mean that the state ownership is highly valued by the market. In fact, it is likely because of the advantageous positions given to the state-owned enterprises before or even after the equitization. In summary, our findings suggest that the reduction of the state ownership will give a lift for the capitalization of the whole market, thereby facilitating the growth of the stock market.

Table 3: Firm performance measured by MTB of state-owned enterprises after listing (2006-2014)

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
MTB(-1)	0.202652***	0.019155	10.57965	0
GOVSHARE	-0.18692**	0.073508	-2.54283	0.0111
STATE	0.068429**	0.034746	1.969431	0.049
LN_MARCAP	0.184555***	0.013919	13.25894	0
DEBT_EQUITY	-0.00014*	7.71E-05	-1.831	0.0672

Source: Thomson Reuters. Calculated by authors

6. Conclusion

This paper characterizes the equitization of state-owned firms in Vietnam and its impact on stock market and firm performance. Our findings show that equitization has brought merits to the stock market but not to its full potential, and that the performance of firms with the state origin is above the average in term of earnings, profitability. Yet, this advantage is likely the outcome of the preferential treatments given to the state firms before they were equitized. This argument is manifested as state-owned firms are valued lower in terms of market value, and further reduction of state ownership can give a tremendous lift for the total market capitalization.

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