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Equitisation and stock-market development

Loc, T.D.

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Part I:
Introduction

Chapter 1

Introduction

1.1. Introduction

Vietnam started a programme of comprehensive economic reforms (*doi moi*) in 1986. It marked the end a period of central planning of the economy. An important component of the transition to a market-oriented economy was measures to reform state-owned enterprises (SOEs), which played an important role in the centrally-planned economy. The aim of these reforms is to improve the performance of SOEs, which was very poor, partly as a legacy of the period of central planning. Among other measures, privatisation (called “equitisation” in Vietnam) is seen as a major instrument to achieve the objective.

The equitisation programme in Vietnam, which started in 1992, can be divided into two stages, namely the pilot stage (from 1992 to 1996) and the expansion stage (from 1996 onwards). During the 12 years of implementation, a total of 2,242 SOEs with a total capital of about VND 17,700 billion (USD 1.12 billion) has been equitised. In 2000 the equitisation programme was accompanied by the creation of a stock market. In July of that year the Securities Trading Centre (STC), located in Ho Chi Minh City, was opened. The stock market has steadily grown although it is still a thin market with only 26 listed companies by the end of 2004. Total market capitalisation at the end of 2004 was about VND 3,945,307 million (USD 250.58 million).

Although privatisation seems to be accepted as a useful method to restructure the economy, it is still not clear under which conditions privatisation is successful, and how it exactly affects firm behaviour and macro-economic performance of a country. Some studies point at success stories (especially in non-transition economies), while others argue that there are major failures, such as the privatisation programme in Russia (for recent surveys see Megginson and Netter,

2001 and Parker and Kirkpatrick, 2005). It is therefore no surprise that a lively debate is taking place on the effectiveness of privatisation. This debate focuses on a long list of issues, such as the optimal preconditions of privatisation, under-pricing of initial public offerings (IPOs), the most appropriate form of privatisation, the effects of privatisation on firm performance and employment, the impact of the economic environment - and especially measures other than privatisation (such as price deregulation) - on the effectiveness of privatisation, the interrelationship between corporate governance and privatisation, and the impact of privatisation on the development of the domestic financial system, especially with regard to the stock market.

Several authors argue that much more research is needed to get a better view of the effectiveness of privatisation (see, *e.g.*, Megginson and Netter, 2001). Among other things, these authors point at the utmost importance of closely examining the process of privatisation by means of country case studies, the importance of precisely calculating the employment effects of privatisation and the need for additional empirical studies on the effects of privatisation on firm performance. In addition, it is believed that there would be a bidirectional relationship between privatisation and stock-market development. Specifically, privatisation might stimulate the development of the stock market by bringing more commodities to the market. Conversely, privatisation cannot be smoothly implemented without an organised stock market that enhances the liquidity of such commodities (stocks).

This thesis aims to contribute to the literature on privatisation in transition economies. More specifically, the study provides a detailed analysis of the impact of privatisation on firm performance in Vietnam. The study also covers stock-market development in Vietnam by, *e.g.*, examining whether the stock market is efficient. Privatisation and stock market development are closely related. Hence, it seems logical to examine both issues in one thesis. To the best of our knowledge, there are no other studies available that deal with the effectiveness of the privatisation programme and the efficiency of the stock market in Vietnam.

The case of Vietnam is interesting because this country's privatisation approach differs from that of most other transition and non-transition economies in that residual state ownership after privatisation and the percentage of shares transferred to insiders are quite substantial in Vietnam. For this reason, the privatisation programme in Vietnam is referred to as equitisation. Although the empirical part of the study exclusively deals with Vietnam, the results of the analyses have a broader reach in that they may provide lessons for other transition and developing countries involved in a process of privatisation.

1.2. Aims of the study

As already indicated the study focuses on two important aspects of the process of economic reforms in Vietnam, equitisation and stock-market development. More specifically, the study focuses on the following issues:

- a detailed description of the process of equitisation in Vietnam;
- the impact of equitisation on firm performance and on employment in Vietnam;
- the sources of performance changes following equitisation;
- a detailed description of stock-market development in Vietnam;
- the efficiency of the Vietnamese stock market;
- The presence of stock prices anomalies in the Vietnamese stock market.

1.3. Outline of the dissertation

The thesis is divided into two parts. The first part, from chapter 2 to chapter 6, is devoted to examining the process of equitisation in Vietnam, in general, and the impact of equitisation on firm performance, in particular. The second part deals with the stock market in Vietnam.

Chapter 2 reviews both the theoretical and empirical literature on privatisation. The review provides a background for the empirical study, the results of which are presented in Chapter 4 and Chapter 6. Chapter 2 starts by giving some definitions of privatisation. The chapter proceeds by summarizing some alternative methods of privatisation that have been widely used in transition economies as well as pros and cons of such methods. In addition, Chapter 2 discusses the efficiency of public versus private ownership by reviewing some theoretical arguments regarding this issue. Moreover, this chapter surveys the empirical literature on the impact of privatisation on firm performance. Specifically, the survey focuses on empirical studies that compare pre- to post-privatisation performance, that compare performance of privatised firms to state-owned ones, and that examine the effect of ownership structure and corporate governance on the firm performance. Finally, the chapter briefly reviews some macroeconomic effects of privatisation that are observed in the theoretical literature.

Chapter 3 first provides an overview of developments concerning policies vis-à-vis state-owned enterprises in Vietnam since 1954. Then, the chapter briefly reviews the equitisation process, including the current status, the role of the state in implementing the equitisation process, and some main features of the equitisation programme.

Chapter 4 examines the effect of equitisation and stock-market listing on firm performance by closely examining two cases, namely Cantho Foodstuff, Fruit &

Vegetable Company and Refrigeration Electrical Engineering Corporation (REE Corp.). The reasons to select these companies are that the two companies are different in terms of their size, the sector in which they are involved, ownership structure, and period of equitisation. Therefore, the case studies can show different dimensions of the impact of equitisation on firm performance in Vietnam. In addition, it is expected that the case studies will provide useful and detailed information on the ownership structure, corporate governance, and policy changes after equitisation of individual firms that cannot be found in other chapters.

Chapter 5 presents the data obtained from a questionnaire and other data sources that are used for the empirical study in Chapter 6. First, the chapter provides a detailed description of the surveys, including questionnaire preparation, sample selection and interview process. Then, it gives the descriptive statistics of the sample with a focus on the structure and size of surveyed firms. Finally, the chapter summarizes preliminary results derived from the survey regarding some aspects of the equitisation process.

Chapter 6 is the main chapter of the first part of this thesis. It deals with the quantitative impact of equitisation on firm performance in Vietnam. This chapter starts by presenting the methodology and testable predictions that are used to test for the impact of equitisation on firm performance. Specifically, this section describes in detail the pre-post equitisation performance comparison method that is derived from Megginson *et al.* (1994) and Harper (2002). Next, the chapter presents the empirical results from a pre-post comparison analysis and from regression analyses. It is to be noted here that in the pre-post comparison method the results are separately computed for the full sample and sub-samples by using the nonparametric two-tailed Wilcoxon signed-rank and the Mann-Whitney U tests, respectively. In the regression equations, which are used to detect the sources of performance improvement, the dependent variables represent the percentage changes in performance measures following equitisation while size, state ownership, corporate governance, stock-market listing, sectors, equitisation years and location of firms are employed as independent variables. Finally, to overcome the shortcoming of the pre-post comparison method that is unable to isolate the impact of privatisation on firm performance from that of other determinants, the so-called difference-in-differences (DID) method is also employed. The main characteristic of the DID method is that it helps to measure the impact of a policy or policy programme by comparing the difference in given measures of a treatment group over time - from before the policy was implemented until after its implementation - to the difference in the measures of a control group for the same periods.

The second part of the dissertation starts with Chapter 7, which describes the Vietnamese stock market in detail. First, the chapter provides an overall description

of the organisation and operation of the stock market. Then, it focuses on principles of the calculation and maintenance of VNINDEX (the Vietnamese stock market price index). Finally, the chapter deals with the performance of the stock market by providing some key indicators over the period from 2000 to 2004.

The aim of Chapter 8 is to provide evidence on weak-form market efficiency for the Vietnamese stock market by using daily and weekly return series of the market index and five individual stocks listed on the market. Stock-market efficiency has important implications for investors because, according to Fama (1970), a market is defined as being efficient if prices fully reflect all available information, so that investors cannot make abnormal profits by exploiting publicly available information. Especially, this chapter focuses only on the weak form (the lowest level of market efficiency) since if the evidence fails to support the weak form of market efficiency, it is not necessary to examine the efficient market hypothesis (EMH) at the more demanding levels of semi-strong and strong-form efficiency (Wong and Kwong, 1984). Specifically, the chapter first reviews the theory of the efficient-market hypothesis and provides definitions of different degrees of efficiency. Next, it gives a summary of selected empirical studies on weak-form efficiency in emerging stock markets. In addition, the chapter presents a detailed analysis of the data and the statistical techniques that are used in testing the hypothesis of weak-form efficiency for the market. A special feature of the chapter is that the market efficiency tests are corrected for thin trading (infrequent trading), which is an important feature of the Vietnamese stock market. In this chapter observed returns are corrected for thin (infrequent) trading by adopting the model proposed by Antoniou et al. (1997). Specifically, a AR(1) model which reflects the number of non-trading days is first estimated, and then returns are adjusted accordingly. Finally, empirical findings obtained from the tests are reported in the last section of the chapter.

Chapter 9 deals with two important patterns of stock-price anomalies, namely the day-of-the-week and overreaction effects. It is worth to note here that according to Fama (1991) stock-price anomalies are incompatible with weak-form market efficiency in that investors can earn abnormal returns by using a trading strategy based on information about price patterns in the past. Among the anomalies the day-of-the-week and overreaction effects are seen as the most important patterns. Therefore, it is useful to conduct a further study on these issues for the Vietnamese stock market if there is evidence that this market is inefficient. Specifically, this chapter first investigates the day-of-the-week effect on stock returns and stock-price volatility for the Vietnamese stock market. The hypothesis of overreaction is tested in the following section of the chapter.

Finally, Chapter 10 provides some conclusions based on the findings of the entire study. Also, the chapter tries to point out some limitations of the thesis and on the

basis of that suggests some issues for further research. Finally, some policy advice to the government of Vietnam is presented.