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CEB Working Paper N° 00/001
August 2000

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August 12, 2000

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Vietnam is a new market economy, being transformed from a centrally planned model, which had been following the Soviet modality for more about 40 years. The year 1986 served to be a turning point, when an extensive reform program called *Doi Moi* was launched during the ruling Communist Party's XIth National Congress.

Doi Moi policy now recognized a *multi-sectoral* economy, which is equivalent to a formal recognition to the Vietnamese private-sector economy and the existence of markets.

Although many substantive changes have happened in the economy since 1986, this paper looks into only one financing aspect of the corporate sector: corporate bonds. This early discussion on a handful of first corporate bond issues in Vietnam tries to understand its current situation and issues that have or may have hindered the development of this important debt finance channel in the country.

1 The Chronology of Bonds in Vietnam

Although corporate bonds have for long become a very popular type of debt finance around the world, they are new in Vietnam's newborn market economy. Before corporate bonds, there had existed some kind of government bonds in Vietnam, called *công trái*.¹ *Công trái* were mainly issued for the public expenditure by the government, where the funds went to large national projects such as building dams, roads, schools or hospitals, etc.

Corporate bonds appeared quite late, only in the early years of 1990s. Since the introduction of corporate bonds, the Vietnamese language has now agreed to call all this type of finance the same name *trái phiếu* for both government bond (*trái phiếu chính phủ*) and corporate bond (*trái phiếu doanh nghiệp*).

While in more developed markets, the a 'bond' refers to the debt instrument carrying a maturity of 10 years or more, in Vietnam a similar instrument with maturity of over one year (greater than 12 months in maturity) is termed as bond.

It is worthwhile to take a look back upon the chronology with respect to our discussed bond as a term financing vehicle, provided in Table (1).

¹This financial asset – a kind of government debt – by definition, promises to give its holders financial payoff in the form of a fixed amount of money at certain points of time in the future.

Table 1: Recent Issues of Corporate Bonds

Project	Issuer	Unit	Value	Year of Issue	Ttm (yrs)	Coupon (p.a.)	Type/Remarks
500KV power line	EVN Corp.	VND	334.0 bn	1992-94	3	3.8-5.0%	Bond/MOF-g'teed; gold-indexed
Cement	Hoang Thach Plant	VND	44.3 bn	1994	3	21%	Bond/S-Treasury-g'teed
Cement	Anh Son Plant	VND	7.5 bn	1994	3	21%	Debenture
Air-con engineering	REE	US\$	5.0 mn	1996	2	4.50%	Bond/Convertible
Steel casting	Southern Steel Co.	US\$	0.46 mn	1995	3	n.a.	Debenture
Power	Yali Hydro Power	VND	200.0 bn	1995-96	3	8.50%	Bond/S-Treasury-g'teed
Tourism	Khanh Hoa Tourist	VND	25.0 bn	1998	5	n.a.	Debenture
Cement	Phuc Son Plant	VND	63.0 bn	1997-98	3	14%	Bond
Financial services	Vietnam Int'l Leasing Company	VND	10.0 bn	1999	5	11%	Debenture/Distributed by ICBV

Source: *Vietnam Investment Review (various issues)*; *ING Barings Research (1998)*; and *author's data*.

In this exploration, corporate bonds, including project-specific debt finance, called *project bond* as used in the early days of Vietnam's corporate debt market, are of the primary concern, with an emphasis on their practicality and technicality. These bonds are issued by and/or on behalf of corporate entities having the need of raising external debt funding other than bank loans.

In this early stage of development, these debt instruments basically reflect the nature of corporate bond. However, one can immediately recognize the 'transitional' signal from them, which could be observed through the fact that most of the issues needed some kind of State's endorsement or guarantee in the issuing process. In many cases, Vietnam's local treasury departments intervene greatly to ensure the smooth sales of the issues.

2 Further Insights

The situation of corporate bonds has gradually changed over time when new companies enter the playing field and more products are introduced. We now look into some early changes, which may pave the way for future development towards a more developed bond market in Vietnam.

2.1 The change in nature of issue

Those cost-concerned issuers shift the industry by further leveraging up commercial concepts inherent in bonds. Table (1) provides us with two typical bond issues that characterize the changes in nature:

1. The convertible bonds issued by Refrigerant Engineering Enterprise (REE Corp.) in 1996; and,
2. Vietnam International Leasing Co. (VILC)'s fixed-rate book-entry bonds issued in 1999.

We need to explain now why these two issues are of importance to our understanding.

Firstly, both of the issuers are defined as private-sector firms. REE Corp became a private sector entity after its *equitization* in 1993. VILC has since its onset been a joint-venture with a substantial portion of equity capital contributed by the Korean shareholder KILC.

Secondly, these issues are not guaranteed or backed by other assets, physical or financial. Thus, by nature these are unsecured debts.

Thirdly, they both have a high leverage at the time of issuing, making it difficult for them to access bank loans.

These successful issues came at the time when the concept of project financing was just introduced into Vietnam's financial system. The bonds look very similar to a project financing instrument, unsecured and judged by issuer's capacity of generating healthy cashflow in the future. That is why we say the issues show a gradual shift from a government-guaranteed debt issue to one that is judged by commercial viability and creditworthiness of the issuers.

2.2 New products, sophisticatedness and higher frequency of issues

The issue of REE's bond to a Dragon Capital-managed fund Vietnam Enterprise Investment Limited (VEIL) carries with it a convertibility term. 'Plain vanilla bond' now has its more sophisticated cousins with more embedded options such as convertibility, callability, putability, etc. Vietnam's industries become more enthusiastic to learn about this methodology of fund-raising, and doubtless expect a more flexible financing options than conventional bank loans.

In this overall picture of Vietnam's corporate bonds, the frequency of bond issues has increased constantly since 1994. Although these numbers provide no ground for the forecasting of Vietnamese future bond market, but since we are talking of the kickoff of a new financing tool, they do give a feel that the value of future bond issues will likely be up exponentially. Those top-tiered State-owned enterprises, which have repeatedly expressed their interests in issuing corporate bonds, include industrial powerhouses such as PetroVietnam, Vietnam Electricity Corp., Vinalines, Vietnam Airlines, etc.

We could expect that banking powers shortly seek to expand their capital base through this type of finance, the act that will serve as a role model for future bond issuers.

3 Risk-Reward Fundamental: 'Caveat Emp-tor'

It requires no more than a simple look for one to understand that bond provides badly needed term finance, given term-to-maturity (TTM) of over three years, for enterprises operating in Vietnam. This fact should be highlighted amid the bankers' sagging morale in providing term lending after serial defaults. In current practices, although not necessarily best, the cost of fund - or coupon payment - on any issue is determined *ex ante* and re-

mains unchanged. The determinacy of cost as usual is most welcome by firms' management.

From the firm's standpoint, the use of bond very much depends on the technicality that determines the way this finance can benefit its own operation. A bond is recognized by its attributes of (i) Term to maturity (TTM: finite term vs. perpetual); (ii) Coupon rate (per cent p.a.; fixed vs. floating); (iii) Coupon payments (annual; semiannual; pure-discount); (iv) Choice of currency; and, (v) Other imbedded options (convertibility, callability).

Technically speaking, these features of a bond determines how the value of that bond fluctuates and changes over time when applicable discount rate changes. However, when the products become more sophisticated, chance is very few could appreciate the terms and know whether a bond is right-priced. The majority of Vietnamese bondholders have not even been familiar with concepts and terms of corporate finance. Thus, they may not know sufficiently that the value of his/her holding is very sensitive to TTM, and thus may have neglected the risks born to them when holding a longer-maturity debt instrument. The public investors have in reality been exposed to a larger degree of uncertainty, which they are not fully aware of. And due largely to this uncertainty, an investor has to accept the principle that the longer their holdings maturity is the less it is priced today.

Also, the underdevelopment of the bond market is a major obstacle to a future efflorescence of corporate bonds. Vietnamese bondholders still do not have a reliable channel to liquidate their holdings, thus tend to buy for holding until maturity. This illiquidity to a large extent prevents the populace from holding a set of bonds instead of depositing funds at banks.

The risk is also represented by the fluctuation of bond price in relation to the changes in applicable discount rate, literally the prevailing interest rate. The word expression of that relationship is that the rate of change of bond price is inversely related to the rate of change in interest rate. These considerations do imply that holders of such long-maturity financial claims in fact take a great risk, and thus should be compensated adequately. Potential investors in bonds should definitely take this into account on a caveat emptor basis, demanding an appropriate level of coupon rate.

4 Could the Vietnamese Corporate Bond Market Take Off?

Bonds are becoming more appealing and clearly an important component in the Vietnamese financial system because it provides for a more flexible

fund-raising vehicle. The need to promote the using of bonds is even further pressed given the fact that local bankers have significantly lagged behind the pace of enterprises' development.

4.1 Market needs that drive the bond market up in the future

Chaos in Vietnam's banking sector in the late 1990s also means that commercial banks fail to address the financing need when they are most needed, justifying the motivation for firms to look up their ways, especially those belonging to the private sector. The banking system in Vietnam continues to provide loans based on the value of collaterals and guarantees by government agencies. Plus, the fast-increasing credit needs in the growing economy of Vietnam almost guarantees a shortage of credit capital in the future, at any time. The majority of private-sector firms and even state-owned ones continue to spend large amount of time on seeking additional debt finances. This is the fertile land for corporate bonds.

For the time being, Vietnam Stock Market is only an infant. Any priority for this market should be place on generating liquidity in the first five years of operation. Fund raising through primary stock market would unlikely be of importance since we cannot expect major funds-raising through IPO or seasoned offerings. In addition, even if the Vietnam Stock Market could address the financing needs for listed firms, the growing population of small- and medium-sized enterprises would still not see this as a financing vehicle since the majority of them would not qualify for listing (Vuong, 1997a, 1998b).

Another fact is that other financing option like financial leasing could hardly become a very important alternative to bank loans (Vuong, 1997). This further exacerbate the overwhelming capital shortage in the economy. The underdevelopment of the equity market would likely continue for a while, despite the existence of a number of investments by funds in Vietnam's emerging equity market. In fact, the majority of offshore investment funds have made loss over past five years in Vietnam, and their shares are traded at deep discount on some international exchanges (see Vuong and Nguyen, 1998c). Therefore, investments by funds would never be able to finance the big gap of needs, not to mention other conditions that make their *modus operandi* difficult for domestic enterprises to tap the finance.

Clearly, the large and fast-growing debt financing needs of domestic enterprises and failure to address the need by the banking system, investment and finance firms, would ultimately lead to the development of corporate bonds, as one of the major financing tools in the economy.

4.2 Conditions for the future development

For the corporate bonds to really work, they critically need a higher level of liquidity to become truly tradable financial assets, to which local securities firms and institutional investors would likely pay attention. No one would argue the positive involvement of securities firms in promoting the issuing and trading of corporate bonds, although the official bourse of Vietnam is promised to open not before July. The more bonds are paid attention to by professional securities firms, e.g. the locally-established Bao Viet Securities, the less likely they are mispriced. However, what missing in the picture still is local competent analysts, who serve to figure out technical issues and provide trustworthy advices.

Thus far, the experience has provided the impression that there appears to be no real difference between the pricing of a very risky bond and that of a near-risk-free one with adequate attention by Vietnamese practitioners. In our sample, most bonds carry the coupon rate of little deviation from a one-year bank lending prevailing in the marketplace, with State T-Bond as a 'standard' reference. It is not unfair to say that the lack of significant public awareness of risk-reward principle in Vietnam contributes greatly to this unusual pricing, in which case firms enjoy the comparatively lower cost of funds even if their financial assets are unsecured and riskier.

In the meantime, critically needed is a comprehensive regulatory framework that enables not only state-owned but also non-state enterprises to be able to issue a wide range of bonds legitimately. This move will certainly pave the way towards a functional corporate bond market and open up the funding channel for enterprises via bond issues. Last but not least, domestic enterprise will have to cope with future financial management standards set by the market and investors, because there will be only a single most important condition for making funds available to them: Remain to be healthy borrower (Vuong, 1998a).

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