A new dawn for corporate bonds

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When investors talk about the bond market in Vietnam, they’re normally referring to long-term government bonds. Since last year, however, the situation has been changing. Investors, especially institutional investors, have been drawn to corporate bonds issued by large state-owned corporations such as Electricity of Vietnam (EVN), Vietnam Ship Building Corporation (Vinashin), and others. Indeed, the corporate bond market in Vietnam has changed dramatically since 2006, thanks to Decree 52/2006, which allows companies to issue bonds through private placement.

Before the Decree 52/2006, it wasn’t clear whether companies could, in fact, issue bonds through private placement to a limited number of investors. Although it’s common in developed markets to sell corporate bonds to institutional investors such as banks and insurance companies, regulations that clearly explain procedures for private placement were highly anticipated in Vietnam. Decree 144/2003, three years earlier, stipulated rules for the public offering of securities, including equities and bonds. And prior to that, securities issued by state-owned enterprises were regulated by a different set of rules in Decree 120/1994. But there was no applicable regulation regarding procedures of private placement by privately-owned corporations. Since bond offerings require extensive information disclosure in addition to the qualifications of the issuer itself, no privately-owned corporations publicly issued corporate bonds under Decree 144/2003, although a few state-owned enterprises issued corporate bonds under Decree 120/1994.

Decree 52/2006 treats state-owned and privately-owned joint stock corporations under the same framework, although there is one main difference: state companies need to obtain approval on the bond issuance plan in advance from the Ministry of Finance, whereas private corporations, according to Decree 52/2006, do not need such prior approval when issuing bonds through private placement. Overall, private placement procedures for corporate bonds are simpler, and it is therefore not surprising to see several corporations issuing more corporate bonds since 2006. EVN raised six trillion VND in total last year, while Vinashin raised about 1.5 trillion VND, later adding another three trillion VND in bonds. Vietnam Machinery Installation (LILAMA) and Song Da Corporation also issued corporate bonds. Some of these were later listed at the HOSE or HaSTC, although trading volumes have been limited, or non-existent.

In fact, one of the Decree 52/2006’s benefits for corporations is the fact that the size of a corporation does not matter when issuing corporate bonds. Unlike public offering as stipulated by the Securities Law, any corporation which at least reported some profits in the former fiscal year may be able to issue corporate bonds. Ironically, however, all the Decree 52 corporate bonds so far have been from large (and well-known) state-owned enterprises. There were also a few state-owned commercial banks and non-bank credit institutions which issued bonds under the State Bank of Vietnam regulations. But no private corporations have issued corporate bonds since Decree 52/2006. Below, I point out three main causes for this situation.

The Advantages of Good Information

The first point is that not all of the financial officers of corporations in Vietnam are familiar with the actual costs and benefits of issuing bonds. Decree 52/2006 itself is relatively new to most of the corporations. Besides, many corporations consider issuing shares and listing their shares at HOSE or HaSTC as more attractive financing tools, mainly because they don’t have to commit to periodical coupon payments and/or the face value, as would be required by corporate bond issuance. (Of course, there is always some self-interest among the management, who often seek personal gains from selling the stock to the public, a common attitude in capital markets all over the world.) In truth, however, corporate bonds can be less costly than issuing shares, especially when investors are concerned about diluting ownership. Corporations must therefore balance the debt (i.e. bonds and loans) and equity (stocks). Financial managers of corporations need to be educated with such corporate finance theories, as well as with guidance on Decree 52/2006. Toward this end, the Ministry of Finance is preparing to publish a handbook on corporate bonds. Once published, the handbook is expected to help readers understand the benefits of bond issuance, as well as the necessary steps taken to issue them.

Secondly, the lack of credit rating agencies (CRAs) in Vietnam should be addressed. Some investors claim this is the main reason only well-known, well-established state-owned enterprises could issue corporate bonds up to now. Without CRAs financial analysts rely on the brand name of the issuer when making decisions about corporate bonds, especially when persuading institutional investors. The result is that only high profile state-owned corporate bonds are accepted by the investors. If there were at least one domestic CRA for domestic corporations in Vietnam, investors could easily differentiate company X bonds from company Y bonds, and would eventually be able to analyze the necessary spread between the two issues as well. Furthermore, when the post-trade information sharing system, which I discuss in the next paragraph, becomes available, the credit rating of traded bonds will be shared so that observers can calculate required credit premiums against each level of credit rating. Without credit ratings, in fact, any post-trade information system for corporate bonds adds limited value. In other words, credit rating is the basis for pricing corporate bonds. Without credit ratings, corporate bond values cannot be appropriately measured. Again, the Ministry of Finance is studying how to establish a regulatory framework for domestic CRAs in Vietnam, with hopes of implementing such a fundamental tool of the financial sector sometime in 2008.

My third point has to do with the lack of an information sharing system. There should be two types of information sharing systems. One is a system for existing corporate bonds, and the other for post-trade information. Since Decree 52/2006 does not require approval from the Ministry of Finance when a privately owned company issues corporate bonds, it is possible for some corporate bonds to be issued without recognition from the government or the public. To encourage corporate bond trading, basic information about existing bonds needs to be accessible to the public.

Post-trade information sharing is even more crucial to the growth and integrity of the corporate bond market. This type of reporting includes information on what bonds sold when, for what price, and how much (volume) was traded. While some trading secrets must be protected, price data, in particular, should be shared among all market participants and observers. For example, issuers should be able to track recent market appetites for credit, in order to determine the best timing for bond issuance, among other practices relying on post-trade information. Better reporting, furthermore, will allow regulators to observe attitudes toward credit risks, which is very important for the SBV. If a credit crunch situation occurs, post-share data would be essential for the SBV to be able to provide ample liquidity. In developed financial markets, the central bankers always watch the credit markets, and intervene whenever necessary, as we saw in recent months after the sub-prime loan problem became obvious.

HaSTC is now setting up a new electronic bond trading system to facilitate the market for listed bonds. Market rules and information sharing need to coincide with launching the new system. If all the points raised above are solved in the near term, the corporate bond market will thrive with a diversity of issuers, issues, and investors.