

# Law on Corporate Governance - The Development Trends of the World and the Problems Posed to Vietnam

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**Abstract** In recent years, following the trend of extensive international integration, prestigious organizations in the world such as OECD, World Bank, IFC,... and countries are trying to develop effective legally regulations and principles on corporate governance. In general, these rules basically affect each other so they have certain similarities which are all emphasizing the importance of independence, transparency and accountability in corporate governance. By researching the development trends of world law on corporate governance, the article will give valuable experiences for perfecting corporate governance laws in Vietnam.

**Keywords:** *Management, Corporate governance (CG), International experience, Development trends, Vietnam*

## 1. Introduction

As a certain result, it is easy to see that the legal systems in many countries are changing day by day to meet the requirements of international integration process. But does it mean that every international integration must introduce the provisions of foreign laws, especially in developed countries quickly without taking into account the internal issues of domestic economy and society? That is a big question that requires a thorough answer.

Firstly, CG regulations in the world tend to converge by many commonalities in the laws on this issue of many countries. There are several basic reasons for this, as follows:

The first is, CG issues, whether in any country, are governed by the same concept: "It is not possible to expect the company board members who manage money of others, to be as cautious as they manage their money" [1]. The company is seen as a "team effort" created by those who own the resources it needs [2], the resources can be capital, labor or knowledge. Therefore, the company's cost and benefit distribution must be fair. Moreover, the model of modern company is joint stock company, or listed company in further coming time, of which there are many small and dispersed shareholders, this kind of company structure is more likely to cause conflicts between owners in resources management [3]. Effective CG requires a separation of ownership and management authorization, but based on that principle, it requires to be assured that company managers would not make full use of the company's money for their own benefit. [4] Although the details may vary from individual regulations, all countries which are interested in regulating CG by law emphasizing the importance of independence, transparency and accountability [5].

The second is, the company's need of globalization is a factor of promoting convergence. The ability to list stocks on one or more of the country's stock markets or international markets on the one hand, can help the company to attract investment from around the world, but on the other hand, can make CG become complicated. Therefore, the law needs to create a mechanism to eliminate or minimize space and time obstacles in CG so that the company can develop sustainably. In addition, some investors who are international organizations would definitely require appropriate CG practices to invest in a country or a company. As developing countries which are growing stronger, creating and re-investing their funds, of course, the demand for investment in domestic market will decrease, along with the influence of foreign institutions increase [6]. "When in Rome, doing as the Roman do", the way of CG that companies are pursuing becomes a "passport" so that those companies can access difficult markets around the world.

Secondly, besides the factors that promote convergence, there are still factors that make a difference between countries, territories and markets.

The first is, the distinction of each legal system line, in particular, the difference between the Common Law system (of Britain, the United States and the Commonwealth countries) and the Civil Law system of continental European countries, Japan and China has caused differences in actual practice of CG regulations. As a result, the provisions of the Corporate Law, the Contract Law, the Bankruptcy Law,... refer to the same CG with various directions of adjustment. In addition, the effectiveness of law enforcement varying from country to country is also a factor leading to different CG regulations.

The second is, these differences in national socio-economic conditions are the causes of many inconsistencies among CG regulations of countries around the world. These are differences of stock market, in terms of market capitalization, liquidity, etc., which greatly make influence the laws and CG's practices. In addition, the ownership structure in different countries is also very various, in which, some countries have companies with family ownership, some other countries have foreign invested ones, but the ratio of individual shareholders to institutional shareholders also varies, while also some countries still adopt structural models such as network, chain, or pyramid for their companies [7]. Also, factors like history, culture and ethics create different Management Board structures or CG practices.

It can be seen that, although the traditional thickness and level of law development in general and CG law in different countries are various, but as mentioned, CG laws are built on the same concept and facing the same global challenges.

The rapid development of science and technology, global competition have set new standards, new requirements on CG, organizational models and management according to traditional standards of many countries currently need to be replaced by the world standard.

## 2. Method

Researching the development trends of law on CG in the world will give developing countries, including Vietnam more valuable experiences in perfecting CG law. Here are 3 major issues that Vietnam needs to care about:

### 2.1. Identifying the doctrine of corporate governance

In recent times, two main theories about CG (Agency Theory and Stewardship Theory) tend to be inclined to Stakeholder Theory [8]. Originating from these basic theories, related to purpose of the company, there are two theories in the world with two opposing views, namely shareholder value theory and stakeholder value. Accordingly, the shareholder value theory considers that company has the sole purpose of maximizing the interests of its shareholders, even based on infringing upon the interests of other stakeholders such as employees, creditors, residential communities. In contrast, the stakeholder value theory identifies that a company is established and operates for the benefit of all stakeholders, so when making a decision, Management Board and the company executive must consider the interests of all stakeholders, but not only shareholder interests.

The theory of shareholder value prevails in the United Kingdom, the United States and former British colonies such as Canada, Australia ... The theory of shareholder value stems from a long-standing view in the UK and the US mentioning that a shareholder is a public owner of the company and is the one who bears the least risk because the shareholder is also the last one to receive back remaining company property when dividing assets in case the company is declared bankrupt or dissolved. [9]. Also, other entities are protected by other legal mechanisms and completely have the right to choose and apply these legal mechanisms before they can become related persons of the company [10].

The clear separation between ownership and management is evident in the views of the United Kingdom and the United States. The risk of the company and its shareholders of being appropriated by company managers through self-seeking deals or being appropriated with business opportunities is enormous. Therefore, the laws in these countries stipulate the existence of the company in order to maximize the interests of shareholders for a better shareholder protection and thus encourage them to invest into the company. This is also consistent with the mechanism of capital mobilization in the Anglo- American countries which mainly base on the stock market. Besides, the shareholder value theory helps improve the business performance of the company because it creates the best environment to enrich wealth and is the basis for economic growth. Requiring managers who run a company to consider other social factors that will distract the company's chief task from making business profit, and thus, affecting the business outcome [11-13].

The theory of stakeholder value developed rapidly in the 90s of the 20th century with the view: No party that contributes to a company's success will be excluded from its decision-making process. The theory of stakeholder

value. This theory is applied in practice in Germany and Japan for two aspects. Firstly, the law of the company stipulates that a person who manages the company when making a decision must consider the interests of the parties involved. Secondly, Stakeholders are directly involved in the company's decision making process. In Germany, the bank, as a creditor, dominates the company's Supervisory Board and Management Board. Similarly, employees are required to have a representative in the Supervisory Board, which elects and dismisses Management Board [14, 15].

Unlike the shareholder value theory that targets short-term goals, the theory of stakeholder value promotes long-term strategies through consideration of broader issues that are likely to impact the long-term success of the company. The theory of stakeholder value reflects new trend of modern society in which companies depend more on the social responsibility that it implements because people today care about the environment and society more.

For countries that introduce foreign CG regulations, determining the theories of CG is a key issue when purpose of the company's existence raises an important question that is not easy to answer to lawmakers. Only on the basis of determining purpose of the company, the legal framework for CG can be built in a consistent and agreed manner.

Basically, the current CG regulations in Vietnam, existing in the Enterprise Law, the Securities Law and its implementing documents, have not clarified the purpose of existence of the company.

From the above analysis, the authors recommend that Vietnam should basically follow the approach of stakeholder value theory because of the long-term values brought about by this theory and because it is also the general trend of the international world in the current period. However, the law regulation also needs to clearly identify what the corrective relationships are in order to specifically orient for impacts, such as the relationship adjustment between shareholders and managers will be different from the relationship between the company and the creditor ... from which to build regulations on the responsibilities and obligations of the manager as well as the provisions on the prevention of conflicts of interest according to predefined theories.

## 3. Results

### 3.1 Building a corporate governance model

Regarding the general CG model in the world, there are two basic models, namely the dual board or two-tier board model and unitary board hay one-tier board model. Which model to organize depends on actual and traditional conditions, and legal mechanisms of each country.

Two-tier board model in corporate law of Germany, Japan and some European countries like Austria, Switzerland, Finland [16] includes a special governance - management structure. In Germany, this model has 2 levels, the upper level is the Supervisory Board and the lower level is the Management Board, in which shareholders and employees will vote for members of Supervisory Board [17-19]. In contrast, the countries following the Common law (USA, UK, Australia, Canada, Hong Kong ...) often have internal governance structures according to unitary board model or one-tier board model, including the General Meeting of Shareholders and only one Board of Directors, consisting of executive or non-executive management

board members who performing the function of managing the company's operations. This model does not have an independent body to monitor the activities of management board members while it is given too much power to carry out its duties. The collapse of a series of large corporations and companies, especially those listed in The United States in the 2000s, formed a tendency to seek and appoint independent people to vote for the Board of Directors - the independent and non - executive member of the Board of Directors, who can provide independent, objective opinions in practices of CG. The United States and countries under the Common Law system are the origin of the non-executive board member or independent member. Depending on the size of the company, how bigger the company is, how higher number of independent members in the Board of Directors is required by the law.

With the growth of the national economies under the common law system, it is entirely understandable that the world trend is to converge on the Anglo-American model, to put the role of shareholders on top, and use market power to regulate the behavior of company executives. The development of similar CG model will make companies organized and operating under this model, so it is easier to close to partners and customers when having a business relationship with each other. However, the complete convergence of a single model is not appropriate because sometimes the values of society, history and culture of each country are also certain barriers for receiving and institutionalizing the law regulations. On the negative side, the Western world has created the most expensive and most likely to suit company control model ever. Crisis risks like listed companies such as Worldcom, Enron ... have also raised many basic questions about the nature of the CG model in the United States and many parts of the world [20].

As an alternative approach, European corporate law is quite open to allow European companies to choose from one of two secondary or unilateral governance models. Similarly, some countries such as France, Belgium, Netherlands, Portugal, and Spain also allow businesses to choose appropriate CG models. [21].

In Vietnam, there are two CG models that joint stock company can choose. The first model has important institutions: General Meeting of Shareholders, Management Board, Director and Supervisory Board; while the second model does not have Supervisory Board but has Internal Audit Board within the Management Board [22]. The second model is a new model and the first model is a familiar one in Vietnam. The first model is not the same as one-tier board model in British and American corporate law because of the existence of the Supervisory Board - an independent agency with supervision of managers and executives of the company. There are also many views that this model of Vietnam is two-tier board model. Although this model is similar to the two-tier board model in Germany, it differs in that the Supervisory Board in a joint stock company in Vietnam is elected and held by the General Meeting of Shareholders. In Vietnamese Enterprises Law, the Supervisory Board has no authority to appoint, dismiss, remove members of Management Board, Director and participates in deciding important issues of the company such as the Supervisory Board in Germany.

In short, the limitations of both models are widely recognized. Under the current conditions, the authors agree with the way of building two CG models simultaneously in

Vietnam today, one traditional and national model is available, one model imported from Anglo-American countries. Every model has its advantages and disadvantages, but through the construction of both CG models, the legislator's idea is to create legal flexibility based on his or her operational practices, as well as depending on preferences, subjective will, which are bases for the company to choose management model appropriated for itself.

Experiments showed that the independence in the member structure of Management Board and the proper realization of the Supervisory Board's functions is one of the criteria to improve the performance of the company through a counterbalance control mechanism in making decisions for the organization and the company operation [23]. Therefore, according to the authors, in order to improve the operational efficiency of each CG model, the laws of Vietnam need to pay attention to the following issues:

Firstly, increase the quality of the company's managers and executives through regulations on the structure of the Management Board, conditions and standards for the managers and executives of the company. Both models must ensure the presence of non-executive board members and independent board members with certain guarantee rates as well as prohibitions on concurrently holding multiple positions in the company or outside the company.

Secondly, creating conditions for supervisory subjects to fulfill their assigned responsibilities through the regulation of the supervisory authorities of Supervisory Board, independent members of the Management Board, Internal Audit Board for the management and administration activities of the Management Board and Directors. At the same time, it is also necessary to specify more details about the responsibilities and obligations for these subjects, that is one of the bases for examining their legal responsibilities when they perform improperly their duties, affecting the rights and interests of shareholders and stakeholders, avoiding the fact that these entities operate formally and inefficiently in companies.

### 3.2 Receive the Code of Corporate Governance

According to the statistics on the official website of the European CG Institute ([www.ecgi.org](http://www.ecgi.org)), 583 CG Codes can be found in more than 100 countries around the world, of which most of them are aimed at companies listed on the stock market. Globally, one of the most popular codes is The G20/OECD Principles of CG. These principles help policy makers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to supporting economic efficiency, sustainable growth and financial stability (G20/OECD, 2015). A series of Codes on CG practices and principles have been developed over the past two decades with an effort to improve CG effectiveness.

When considering the mechanism of legislating good practices in the legal system, it should be noted that the system of regulations relating to CG is both formal and informal. In essence, the CG Codes of international organizations and countries are non-legal guidelines intended to supplement the law and other provisions of CG laws. CG Codes are like "soft laws" - companies don't necessarily have to implement them, but if they don't apply, they have to announce to the market. This approach allows

companies to be flexible in applying CG Codes, thereby encouraging a fair balance across many types of businesses. Recently, World Bank conducted a survey of 105 capital markets already have a CG Code, of which 65 markets have a “Compliance or Accountability” Code and 25 capital markets have a “Voluntary” Code [24]

With the above-mentioned contents, in Vietnam, the development of CG rules should be based on the receipt of the CG rules, specifically as follows:

Firstly, continuing to institutionalize OECD principles’ problems and good CG Codes around the world into legal documents.

Secondly, it is necessary to soon develop and perfect CG Codes, specifically applied for listed companies, banking, and state-owned enterprises. As common practices in countries with developed markets, the Corporate Law (or Enterprise Law) only provides principle-based CG regulation and principles or CG rules which ensure minimum compliance. In addition, the regulatory agencies in the fields will develop a set of CG principles that will guide business performance. Currently, in the legal and practical context in Vietnam, CG guidelines should also be specific, including two main content groups: The content group required to implement and the content group with principles to ensure the feasibility of the good CG implementation.

Thirdly, from issues 1 and 2, it is necessary to specify which content should be legalized, which content should be specified in the CG Code. Many countries have revised legal documents on securities and banking, as well as regulations on listing securities to solve new problems. The contents from the CG Code are institutionalized into the Law showing the importance of CG, from which businesses must apply. The content that is included in the Law will be removed from the CG Code. Due to their unique characteristics, businesses may not be able to follow the principles of CG. Therefore, regulatory agencies and law enforcement agencies need to consider issuing specific provisions in the law, ensuring minimum compliance.

Fourthly, the law should specify the agency that supervises and enforces this CG Code’s implementation. A recent OECD study on monitoring and enforcement procedures in 27 countries has shown that 19 countries established their national regulatory agencies carrying out CG’s control and supervision. France, Hong Kong, China, Italy, the Netherlands, Singapore, Sweden and the United Kingdom are among countries and territories of developed economies that regularly review and report on compliance of enterprises to the CG Codes. The monitoring of CG implementation is often better implemented in developed countries.

Fifthly, it is necessary to include requests on the interests of stakeholders, especially sustainable development, into the CG Code at an early stage, then institutionalize by legal regulations when the companies have complied with it.

Thus, in the context of the current legal environment in countries, the Corporate Law (or the Enterprise Law), the Securities Law, the Law on Credit Institutions only provide basic CG principles, current CG guidelines or CG Codes in Vietnam should be developed in a manner consistent with OECD’s CG principles, in line with the prevailing international CG trends in many countries with developed markets. Therefore, Vietnam need to grasp trends and

adjust its legislation on CG properly. This will play an important role in bridging the gap of company CG quality in Vietnam compared to other countries in the world, thereby improving the competitiveness of the economy in the process of regional and international economic integration.

#### 4. Conclusion

There is no single model of good corporate governance, however, these trends underlie good CG. For developing countries, because they cannot be out of the international economic integration trend, so adapting their legal system to the rationality of the world market becomes the first and compulsory requirement. In the process of changing to catch up with this general trend, Vietnam on the one hand need to acquire progressive values, in line with international practices and customs, on the other hand, it is also necessary to take traditional factors, customs, especially internal conditions in the market economy in its country into consideration to improve and fulfill the CG law. It is time for Vietnam to consider eliminating differences that should not be in the system of CG law to take further steps, to converge with major countries in the world in the process of integration.

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