DEVELOPMENT OF CORPORATE BOND MARKET

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Abstract

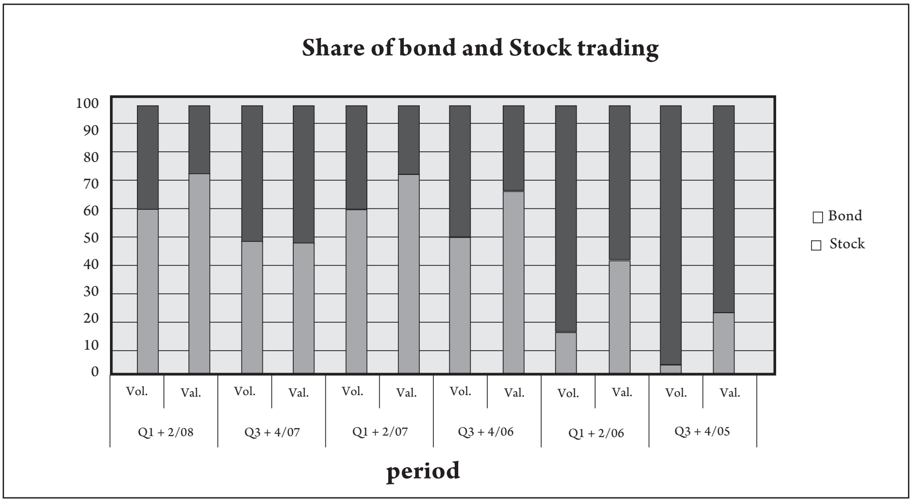
In a transition economy like Vietnam, fund demand for development is increasing year by year. By the beginning of the Doi moi period, the total investment capital raised sharply from 2.9% of GDP in 1990 to 45.6% of GDP in 2007. The Vietnamese government has made many efforts to encourage raising this huge amount of funds. The bond market is one of the most essential mobilizing fund channels not only for national projects but also for private ones. However, in contrast with the booming of the stock market, the bond market is still under-developed, along with poor management, many policies and inherent risks should be considered. This paper points out some shortcomings in the development of the bond market as well as suggesting some policy implications towards a sustainable and strong development of this market.

1. Overview of Debt Market in Vietnam

The debt market in Vietnam consists of T-bills, Government bonds, municipal bonds, corporate bonds and certificates of deposits and other debt valuable papers. It is obvious that bonds dominate the debt market. The bond market in Vietnam is considered small in terms of size, and immature in terms of the level of standardization. This is a growing market that attracts foreign investors' interest.

At the end of the year 2007, there were around 570 government and corporate bonds listed in the market. The total value of these at par value coming to around 115,560,000 billion VND. Government bonds trading in the secondary market account for the major part of total market value. Statistics from the Vietnam Stock Exchange (VSE) from the end of 2005 to the first half year of 2008 show that they account for only around 5% in 2005, rising to nearly 50% in 2006 and in 2007, and more than 60% of the total market value in the first two Quarters of 2008. To compare with stocks, the amount of stock trading has decreased between 2005 and 2008 both in terms of value and volume. In 2005, stock trading accounts for more than 80%, but this number is only just below 30% in 2008. Although the stock market has developed faster than the bond market in terms of liquidity, the total amount of funds raised by issuing bonds is much greater than issuing stocks. This shows the importance of bonds, especially government bonds as a main funding source for investment.

Graph 1. Share of Bond and Stock trading in 2005-2008



Source: www.HASTC.org.vn

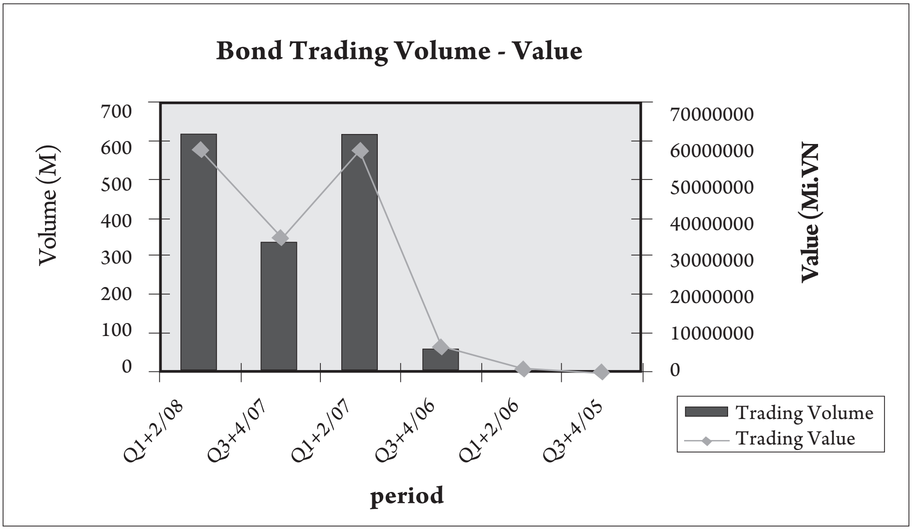
Among the three types of bonds currently issued and traded in Vietnam, including Government T-bills and bonds (normally considered Government bonds in general), municipal bonds and corporate bonds, the volume of Government bonds dominates the bond market with 81% market share, with municipal bonds at 10%, and corporate bonds 9%[1]. Volumes traded of those bonds for the period 2005-2008 are illustrated in the Graph 2.

For the 5 year period 2006-2010, GDP is expected to grow at 8% - 8.5%, total required investment capital is estimated of VND 2,675,000 billion, accounting for 39.9% of GDP. The demand for bonds to be issued is therefore estimated of VND 187,250 billion[2]. Of which, Government bonds account for the largest share in terms of number and value.

[1] As of end of Quarter III 2006, Banking and Finance Department, MOF.

[2] The 5 Year Debt Management Plan, Banking and Finance Department, MOF

Graph 2. Bond Trading Volume - Value



Source: www.HASTC.org.vn

Government Bonds and T-bills

T-bills in Vietnam are considered to be short-term debt papers with maturity of either 182, 273 or 364 days while Government bonds are those with a maturity of 7, 10, or 15 years. There are over 450 different types of T-bills and Government bonds currently being traded. VND 60,000 billions worth of Government bonds are issued annually by State Treasury and Vietnam Development Bank through mainly underwriting and bidding (auctioning) channels. Retail selling of Government bonds through State Treasury branches and other agents will be eliminated. The planned issue of T-bills and Government bonds all together for 2007 is VND 60,000 billion, of which T-bills account for 45%[3]. Government bonds are now issued mainly through underwriting, bidding though securities transaction centers and SBV Transaction Center.

The Government bonds and T-Bills market is mostly active in the primary market, not the secondary one. After innitially being issued, those bonds are held up to the maturity by commercial banks and larger corporations for liquidity management.

Municipal Bonds

The municipal bonds are issued by the local governments under permission of the Government. There have been so far Hanoi City, Hochiminh City and

[3] State Treasury, Planning Department

Dongnai province that issued bonds to fund their capital expenditures. Provinces are allowed to borrow up to 30% of their total capital expenditure and need to seek approval from the Government to issue bonds. The total value of municipal bonds outstanding is VND 7,000 billion. These bonds are issued through auctioning, underwriting and agents channels. However, the liquidity for this kind of bond is very poor.

Table 1. Municipal Bonds Issuing

No	Issuer	Maturity (year)	Yield (%)	Issuing date	Listing date	Listing Volume
1	Hanoi People Committee	5	9.07	20/10/2005	28/10/2005	1,500,000
2	Hanoi People Committee	5	9.1	1/11/2005	7/11/2005	8,550,000
3	Hanoi People Committee	5	8.7	24/10/2006	3/11/2006	400,000
4	Hanoi People Committee	5	8.75	27/10/2006	6/11/2006	4,600,000

Source: www.hastc.org.vn (24 July, 2008)

Corporate Bonds

Issuers include SOEs in transition to joint stock companies or large corporations. The total value of corporate bonds outstanding is over VND 17,000 billion (in 2007). These bonds are issued through auctioning, underwriting and agents channels. However, the liquidity for this kind of bonds is very modest. This bond market will be discussed further later.

CDs and valuable papers

CDs are considered valuable paper and attract deposit insurance. CDs could be in one-year or longer term. The 90 day residual maturity restriction on trading of valuable papers is applied for Open Market operations in which SBV buys or sells valuable papers only, and not applied for forward transactions. This restriction is for short term monetary policy conduct purposes of SBV. Normally SBV makes quarterly forecasts of the liquidity in the market, and 90 days are the number of days for a quarter. SBV has no intention to lift this restriction even though they are aware of complaints about this from credit institutions. There has been so far no official banking forum or association discussing this issue.

The Ordinance on Commercial Papers approved by the National Assembly on December 24, 1999 was replaced by the Law on Transferable Instruments which was approved by the National Assembly on November 29, 2005 and came into effect on July 1, 2006. The Law regulates commercial papers and cheques. This new law is expected to enhance the trading of commercial papers and improve their liquidity.

The debt market in Vietnam is still in its first stage of development with high potential development of Government bonds. Vietnamese Government bonds have been recently considered attractive to domestic and international investors in terms of interest rate and safety. However, the corporate bond market is a potential capital source for firms, especially in an increasingly developing financial market like Vietnam's. The main concern is how to encourage firms to use this capital effectively in their planning capital structures.

2. Main findings from corporate bonds issuing

2.1. Number of firms and volume of capital raised from bond market is still limited

Issuer

Up to now (June 2008), there are only 11 corporations issuing bonds, including: PetroVietnam, Vinashin, Electric Vietnam Corporation (EVN), Lilama, Vietnam Steel Corporation, Vilexim, Electric Construction Corporation, Song Da Corporation, Vinaconex and Vincom. In the first 6 months of 2008, due to the slowing down of the security market, no institution issues new bonds, except Vincom. Most of the issuers are the largest corporations or equitized SOEs. In fact, their fund demands are mostly huge long term and sustainable ones for targeted national projects which is difficult to borrow solely from a bank. Their worthiness are quite good to approach to any banking loan, however, because banks also have some limitations in giving loans such as a maximum loan must below 15% of bank's equity. Then, the bond market is an essential channel to raise a huge long term funds.

Outstanding

The total debt outstanding from bond issues recently increased sharply. From 300 billion VND issued by PetroVietnam in 2003, raised to 6,600 billion-VND in early 2007, especially, in 2006, the total fund is more than 8,800 billions VND, in which, EVN issued 6 series with 6,000 billion VND. The total debt outstanding from issuing bonds from 2003 to 2007 reached 17,068 billion VND. From which, EVN and Vinashin are the largest issuers, accounting for 41 percent and 36 percent respectively. The other corporations' outstanding bond debt only account for 10 percent of total funds raising. These figures are in accordance with

Table 2. Current corporate bond issuing

No	Issuer PetroVietnam	Outstanding (billion VND)	Year to maturity	Interest rate 8.5% first year, + floating
1	PetroVietnam	300	5	8.5% first year, + floating
2	Rubber Corporation	40	2	8.60%
3	Vinashin	7,103		
	Year 2004	300	2	8.20%
	Year 2005	1,000		
	Year 2006 (5 times)	2,600		
	Seri 1	500	2	9,6%/ annual
	Seri 2	300	2	9,6%/annual
	Seri 3	500	5	10%/annual
	Seri 4	1,000	10	10.5%/annual
	Seri 5	300	2	9.6/annual
	Year 2007	3,203		
	Seri 1	3,000	10	9%/annual
	Seri 2	200	2	8.95%/annual
	Seri 3	3,000	10	9.4 %/annual
4	Sông Đà Corporation	460		
	Year 2005	200	3	9.3%/annual
	Year 2006	260	5	First year 10.5%/annual, then floating
5	EVN	6,200		
	Year 2005	200	5	First year 8.8%/annual, then floating
	Year 2006			
	Seri 1	350	5	9.6%/annual, floating+ 1.2%
	Seri 2	1,150	5	9.6%/ annual
	Seri 3	500	5	9.6%/annual then floating
	Seri 4	900	5	9.5%/annual then floating
	Seri 5	600	5	9.6%/annual
	Seri 6	500	5	9.6%/annual, plus deposit interest
	Seri 7	1,000	10	9.6%/first year, then 9,95%
	Seri 8	1,000	10	fixed 9.7%/annual

6	LILAMA (2007)	1,500		
	Seri 1	500	5	9.60%/annual
	Seri 2	1,000	10	9.20%/annual
	Seri 3	500	5	8.8 %/annual
7	Vietnam Steel Corporation (2007)	400	5	9.5%/annual
8	VINACONEX (2007)	1,000	6	3%/annual + warrant
9	VN Electronic Construction Corporation	500	3	10.15 %/annual
10	Vilexim (2007)	5	3	
	Total	17,068		
11	Vincom (2008)	2,000	5	16% for the first year, then equals to deposit interest of 4 largest commercial banks + 4% at most (May 2008)

Source: MOF, 2007

the huge demand for funds of these two corporations; they are also the most attractive bonds in the market currently. Vinashin issued bonds financing shipping projects aiming at becoming the largest shipping exporter. EVN also issued bonds for investment in hydroelectric plants to meet an increasing pressure of power demand. EVN also pursued a strategy to issue international bonds in value from 300 to 500 millions USD and soon become rated under international bond rating.

Despite rapid growth, this capital is still minor in comparison with banking loans. From 2002 to 2005, credit growth reached 25% annually, but from 2006 to 2007, this growth decreased significantly, only 15% in average annually. In 2007, the credit growth increased sharply to more than 45%, in some banks this number is even more than 50%. However, this development of banking credit does not provide finance for business and production only, a large portion is spent on stock lending. The booming of the stock market in this period can be illustrated by the change of firms in raising capital, switching from banking loans to issuing shares to gain capital. (See more on 2.4).

Maturity

The bonds' maturity is long term, ranging from 2 years to 10 years. Bonds issued by EVN are 10-year-maturity. They are issued to finance the hydroelectric plants and national electric network improvements. Bonds issued by Vinaconex and Lilama will mature in 5 years. To increase the incentives for investors, Vinaconex issues bonds with warrants to buy shares of Cam Pha cement plant at a preferable price. In the developed financial markets, bonds usually have a maturity of up to 20 to 30 years. These long term funds could never be given by banks. However, in Vietnam currently, faced with high inflation, an uncertain policy environment, and much affected by external economic conditions, which cause the uncertainty of investor's confidence to invest in an extremely long term bond.

Interest rate

The bonds' interest is paid at the end of the financial year as a coupon. Only Song Da corporation's and EVN's bonds are flexible interest rates, adjusted by Government bonds or inter-bank monetary market interest. Basically, bonds' interest rates are higher than the bid successful interest rate of Government bonds. (see Table 3)

Table 3. Bid interest rate of Government Bond

	Qua. 3/05	**Qua. 4/05**	**Qua. 1/06**	**Qua. 2/06**	**Qua. 3/06**	**Qua. 4/06**	**Qua. 1/07**	**Qua. 2/07**	**Qua. 1/08**	**Qua. 2/08**
Interest rate (%/annually)	8.95	9.07	8.95	8.75	8.4	8.8	7.7	7.15	NA	11

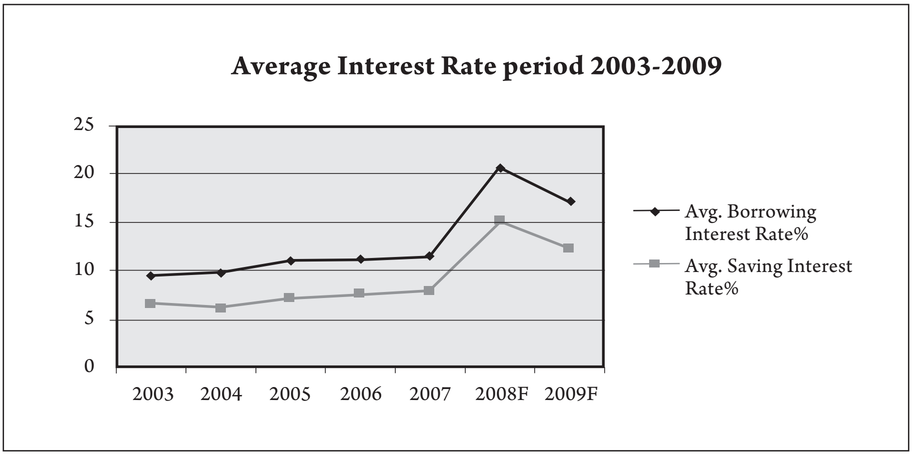
Source: HASTC (www.hastc.org.vn)

In the period from 2005 to 2007, government bonds interest rate issued by bidding ranged from 7.15% to nearly 9%. In comparision with the saving interest rate at that time (from 7% to 8%) this is an attractive investment opportunity and safety. From early 2008, due to high inflation and the slow down of stock market, bid interest rate of Government bonds increased rapidly to more than 10%, however, this rate is much lower than the saving interest rate (approximately nearly 20%), then, the total value of Government bonds issued at this time is only more than 21,000 billion VND.

However, they are still far below the borrowing rate from banks (on average, from 12%-14% annually for long term loans). In fact, they are a nominal rate, not a real rate, in the context of higher inflation, the real interest rate trends to move below zero. This could be explaining why private investors seem to be indifferent with bond holdings. The investors are almost all institutions such as banks, insurance companies or large corporations. They hold bonds for liquidity management not for profitability.

Compared to the interest rate of Government bond in the same tenor, it could be seen that the interest rates of corporate bonds fluctuate together with

Graph 3. Borrowing and Saving Interest rate



Source: Economist Intelligence Unit

the Government bond interest rates (See Table 4). The interest gap between them ranges from 2.5 percent to 3 percent, reflecting the risk difference between these bonds. The Bloomberg benchmark is the interest rate of VN Government Bonds calculated by Bloomberg based on their estimation.

In fact, depending on the time and tenor of issued bonds, could this gap really reveal the risk premium? For example, in 2005, Vinashin issued bonds with 5 year tenor, at that time, government bonds with the same maturity were being sold at 8.5%, but Vinashin bonds were not "permitted" higher than government bonds (8.4%). Then, to attract investors, Vinashin had to pay interest before rather than after interest payment, causing the real cost of raising funds to be approximately 8.9 percent.

Table 4. Interest rate of corporate and government bonds

Tenor	2 yrs	3 yrs	5 yrs	7yrs	10 yrs	15 yrs
Last trading Gov. bond	7.3	7.67	7.9	8.2	8.7	8.85
Current issuing, Gov. bond	7.2	7.35	7.86	NA	NA	8.4
BloomBerg bench mark	7.475	7.679	7.921	8.217	8.461	8.792
Corporate bonds	9.6	8.5 - 9.3	9.6 -10	NA	9.7	NA

Source: www.ssi.com.vn (Otc- 2007) and author's estimations

Besides the interest rate, the issuers have to pay a fee or commission in term of underwriting for issuing agents. Depending on issuers' credit-worthiness, this fee could be remarkable, it will mark-up the effective cost to 12 or 13 percent annually. The less credit-worthy the issuing corporation, the higher the issuing cost. This is also one of the main barriers for SME to issue bonds in Vietnam now.

Difficulty in issuing bonds in the context of increasing interest rates

From early 2008 up to now, the interest rate is changing unbelievably. Due to a shortage of liquidity in banks, as a result of tightening monetary policy, the basic interest rate which is declared by the SBV and used as the benchmark for commercial bank interest rates, raises day by day in most periods, from nearly 7.5% in January up to the highest point in June, 13%. As a consequence, the discounted rate and refinance rate that SBV applies to loans to commercial banks increase also. This increasing will lead to sharply increasing borrowing costs. Then,few firms could issue bond at that rate. In addition, the slowing down of security market in the first two quarters of 2008 make it more difficult to issue new bonds.

Underwriting

Currently, issuing agent is the most popular underwriting method. The chosen issuing agent will be in charge of providing issuing consultant services including underwriting, issuing and making coupon or principal payment. Security companies are key players in this market, besides joint-stock banks, insurance companies and auditing companies. With the advantages of information and professional staff, they are the main providers of these services. Currently, issuing consultant services are still under-developed, their revenue share of this service account for only from 5% to 10%. The security companies belonging to banks who have a national branch network will be issuing agent for commission, without this, the issuers could not sell a huge number of bonds.

Table 5. Basic interest rate regulated by SBV in the first 6 months 2008

Period	1/2/2008	19/5/2008	11/6/2008
Basic interest rate %	7.5	11	13
Discounted rate %	8.755	12	14
Refinance rate %	6	13	15

Source: SBV.gov.vn

2.2. There is no credit rating institution causing risk of insolvency

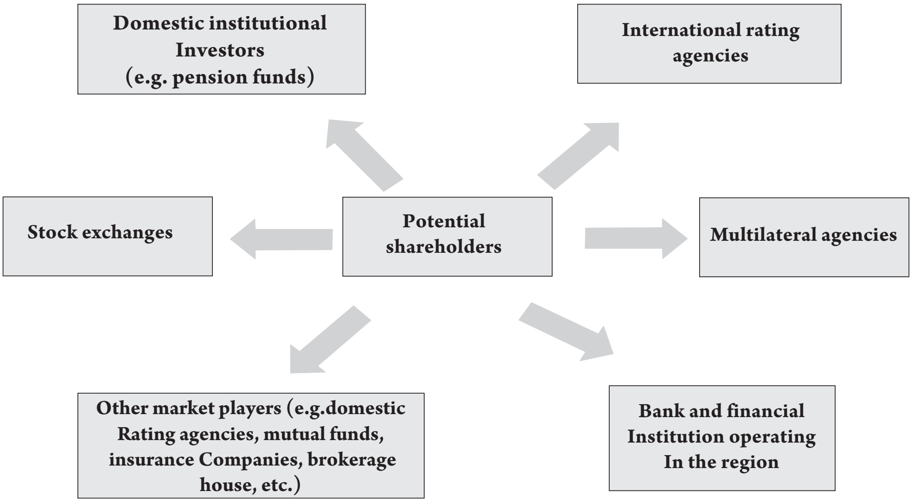
Credit rating is one of the most important things to be considered in loan approval process. This reflects obviously the borrower's financial situation, such as solvency, capital structure and profitability. Besides financial ratios, some non-financial criterion such as: management skill, business experiences, manager's capacity etc...These ratios will be rated and compared with industrial ratios. Then, all component ratings will be consolidated into an overall rating. Finally, borrowers will be ranked from A to C. AAA rating is the best borrowers, who have good solvency, high profitability and can be expandable credit. B rating should be credit rationed, closely controlled, quickly collect previous loans. C rating is the worst borrower who cannot be given any loan, collect previous loan immediately, proceed to liquidation procedures if necessary (CIC, 2007).

Credit rating in general or bond rating in particular is a crucial tool for policy maker to regulate market. Both government bonds as well as corporate bonds will be rated by regional credit rating institutions. Information relating to creditworthiness or ranking of issuers will be publicized not only in nation-wide but also regional and global network. Especially, such corporations planning to issue international bond like Vinashin and EVN will be rated by a regional credit rating institution. The model of potential shareholders credit rating institution suggested by the World Bank (Swati R.Ghosh, 2006) seems to be applicable in Vietnam. This institution will operate in the form of a shareholder company, including domestic investors, banks, insurance companies, stock exchange, multinational investment companies and international credit rating institutions (Graph 4).

However, in Vietnam, there is not any professional institution providing this service, so the standard of corporate bond ratings has not been developed. Some auditing companies have made much effort to diversify their consultant services, but, as they have a shortage of human resources, their market shares are dominated by auditing services, SOE's equitization services and evaluation services.

In December, 2007, CIC (Credit Information Center), SBV in cooperation with Dun and Bradstreet, a global leading company in providing information, published the book "Credit rating of listed companies in Vietnam stock market" to publicize the credit rating of 198 listed companies at 24th August, 2007 (excluding banks and funds). Most of the listed companies received rating B or above, only 7 companies rated CCC, accounting for 3%. This information is crucial for banks and investors, however, they are only meaningful at the time of rating, not for the whole period. If credit ratings would be done periodically, at least monthly or quarterly, they would be much more helpful for the users. Cur-

Graph 4. Potential shareholders for the regional credit rating agency



Source: East Asian Finance, The Road to Robust Market, Worldbank, 2006

rently, CIC provide credit rating services only under requirements with rather high cost. So, the individual investors could not approach with this information, only when CIC published this book.

In fact, most of the issuers currently are the largest corporations in each of their industries. Their financial situations are much better than the average industry. Besides that, some issuers are underwritten by the Government, so their solvency risk is very little. However, to develop the bond market to encourage firms to issue bonds, it should be set up a standard of credit rating or bond rating should be set up. Especially, with the trend of globalization, when corporate bonds will be listed in foreign stock markets, corporate bonds should be rated under international standards[4].

2.3. Lack of market makers

The bond market makers play two roles: broker and trading bonds, then they can get profit from these functions. First, as a bond broker, the market makers could make profit from the commission that the issuers paid for them,

[4] At present, only VCB and BIDV are rated under international credit rating standards, then their bonds' interest rates are similar with government ones. When government rates go down, corporate bonds rates will be more attractive as coupon rates are higher, under the same ranking with government ones.

and the second, as a bond trader, they could get the premium by price arbitrage. Bond price is dependent on interest rate, it will go up when interest rate go down and vice versa.

However, bond market trading is riskier than broking. To play the function of market maker, requirements are complicated and high cost: (i) holding a large amount of bonds and cash, (ii) high-tech infrastructure, (iii) high skill and professional employment. Moreover, when bond prices go down, or the risks of insolvency emerge, the market maker will lose money (Trần Đăng Khâm, 2007).

The information obtained by market makers is primary data, so they could take advantage of it, but they also could get loss when there is inside information. The market makers must buy when price goes up and sell when prices go down[5]. The potential loss shall be large in the market where the bond's price is affected heavily by the investors' psychology. Vietnam bond market is an obvious illustration. In the inefficient financial market, investors' psychology is the oriented element affecting the selling or buying decisions. It's the market makers help to balancing demand and supply forces when there is in un-biased information.

In fact, securities companies are professional traders in security market. They have advantages in broking and dealing, so they could create strong relationship between institutional and private investors, then they could increase the liquidity of trading bonds. This is one of the main concerns of policy makers, it's the low liquidity of bonds causing the under-development of this market. With the booming of the security market last year, all securities companies are attracted by the commission and fee from security dealing, they seem to not be interested in bond trading or dealing. In the near future, when the bond market is seperated from the security market, they do hope to diversify their portfolio investment to contribute to development of market makers.

2.4. Low market liquidity

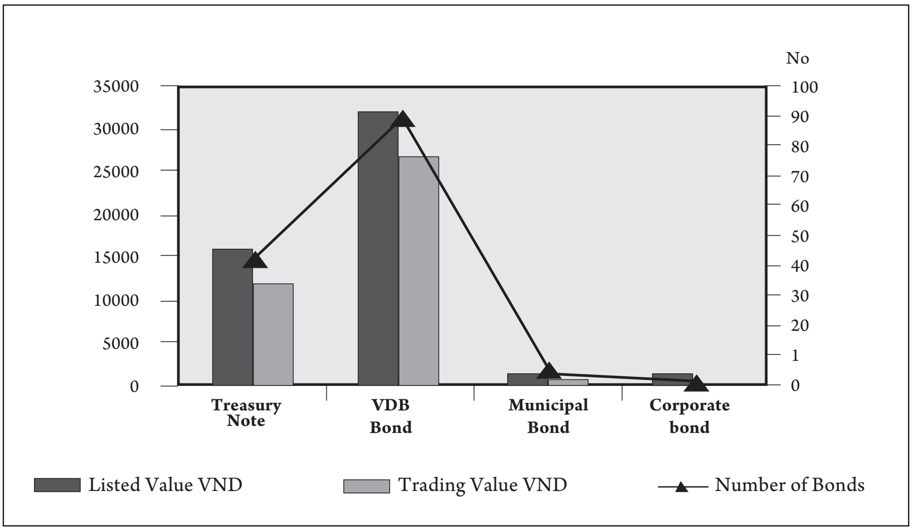
This is argued as a crucial element causing under-development of bond market. Why stock market is booming while bond market is still a newly born market, only dominated by primary transactions. To have a look inside, it could be explained by some reasons. First, bond interest rate is fixed, then its price fluctuates with a small range so investors could not find high potential profit from bond investments. Therefore, the secondary transaction is not as much as stock transactions. Second, institution investors like banks and insurance companies will

[5] Market maker must be buyers or seller when private investor have selling or trading orders, with a minimum bond batch, say 100 bonds.

hold bonds for liquidity management not for profitability management. Then, they prefer government bonds than corporate bonds. Therefore, the secondary transactions of corporation bonds is very little, most of the tradings deal with the government bonds. Especially, for the bonds of the corporations which are not listed in the stock market, the investors will hold until the due date.

At present, in HOSE (HoChiMinh Stock Exchange), there are only two corporate bonds listed including BIDV's. In HASTC (Hanoi securities trading center), there is only one. Since July, 2008 all corporate bonds and Government Bonds has beguin traded in HASTC only. The trading value and the number of listed corporations' bonds are also modest numbers (see Graph 5). The biggest share is still Vietnam Development Bank (VDB)'s bonds (45-50%), then Government bonds issued by Treasury (35-40%), the rest is municipal bonds (5-10%), corporation bonds are only below 5%.

Graph 5. The structure of bond transaction



Source: www.hastc.org.vn, 12/2007

Among three types of corporate bonds traded in HASTC, in fact issued by only EVN and PVFC. PVFC is a financial company, they issued bonds mostly for providing financial services. This issuing is much different from issuing bonds of business company like EVN.

Table 5. Bond trading in HASTC

No	Issuer	Maturity (year)	Yield (%)	Issuing date	Listing date	Number of listing
1	PVFC	3	9.05	19/06/2006	12/7/2007	3,645,986
2	EVN	5	9.5	20/07/2006	16/07/2007	9,000,000
3	EVN	5	9.6	1/9/2007	24/09/2007	6,000,000

Source: www.hastc.org.vn (24 July, 2008)

The members of bond market includes commercial banks, security companies, insurance companies, investment funds, financial companies and other intermediate financial institutions. However, the most potential market makers are considered as commercial banks and securities companies. The first one are big investors in the issuing and trading bond market. They should be market makers as well as bidders or underwriters. In Vietnam, up to now, there are only Vietcombank (VCB) and IncomBank (ICB) playing as the main brokers and underwriters. The two other state-owner commercial banks are VBARD and BIDV, some joint-stock banks, and foreign banks like CitiBank, HSBC, Deutsch Bank, Standard Chartered Banks also get to start.

2.5. The low cost of issuing stocks prevent firm from issuing bonds

In the period of blooming of the stock market (2006-early 2007), it was much easier for firms to mobilize funds by issuing stocks than banking loan or issuing bonds in providing that their financial situations could be rated at B ranking. Even firms who was in the process of establishing could sell all stocks in a short of time. The popular investors were easily attracted by stocks that could be sold at a price of as 2 or 3 times as par value. Obvious, such mass issuing stocks created risks for investors. After issuing, investors could hardly check or assure that funds mobilized from issuing stocks could be invested in what area or projects that firms proposed. Some firms deposited this fund in the bank, then they used deposit interest to pay for dividend, without doing any business. It's unbelievable but is the fact. Because of additional capital (the total amount of capital by selling stocks at the price that is much higher than par value), deposit interest (calculated on this amount) is much higher than dividend paid for stockholders (calculated on the par value). This could not happen in the efficient financial market, but it could in Vietnam. The price of stocks were pushed up over their present value or intrinsic value (PV), forced investors to face up with both business risk and financial risk in the near future when firms fail with doing investments.

On the other hand, cost of capital when issuing stocks is much lower than issuing bonds or banking loan. Even cost of debt is deductible before income tax, however, additional capital reduces the effective cost of equity, then encourage firms to issue stocks not bonds. Therefore, only if PV of stocks will be evaluated exactly, firm must rely on cost of capital to choose issuing stocks or bonds in their capital structures to maximize firm's value.

2.6. Yield curve has not been built up

Yield curve reflects the relationship between the maturity and the yield to maturity of a bond at a certain time. Yield curve is set up base on government bonds or high ranking corporate bonds which are free risk of return. Therefore, these interest rates are used as benchmark for other bonds. The gap between this benchmark and others shows the inherent risk of these bonds, the widen gap is the higher risk will be. Some certain requirements need to be considered when setting up a yield curve. First, bonds are standardized, that mean bonds should be the same in coupon and issuing conditions, and the same industry. Second, bonds are available for daily trading and listing. Third, at a certain trading day, different maturity bonds are traded, this is important requirements to draw a yield curve.

Currently, there is still no yield curve for coporate bonds in Vietnam. In fact, Vietcombank got start corporation with Reuters and HOSE (HoChiMinh Stock Exchange), but has not succeeded yet. One of the main reasons is that there are too many kinds of bonds then transactions are dispersed. On the other hand, repos and forever tradings are not separated therefore, interest rates do not match with market ones.

3. Policies implications

Improve the transparency and information disclosure in the security market

This is the first requirement for a strong efficiency of financial market. In a strong efficient market, all information are equal to every investors or market members. The information relating to financial situation of issuers are reflected exactly and fully in security price. In Viet nam, all listed companies have to publicized their financial statements periodically and they are all external audited. However, the accuracy and adequacy of these reports sometimes non-confidential. Even some firms try to have some "window dressings" some sensitivity ratios to make them better looking. These actions will make investors' evaluation is distorted. Then, hardly they can define the intrinsic value of stocks or bonds.

Therefore, a set of strict regulations on clarify and disclosure of financial situations will be issued to help investors easier in making investment decisions. All information and data disclosed publicly should be audited and supervised by authorities, especially the information relating to changes in firm management and solvency. All financial statements provided by listed companies should adopt Viet nam Accounting Standards at first and then International Accounting Standards. This requirement will help firms easily when issuing or listing in the regional or international market.

Separate bond market and stock market

Characteristics of bond and stocks transactions are much different. Bond transactions are direct negotiation not order matching tradings. The traders are also investors, so they need to negotiate directly. Trading system is always designed as a combination between negotiable trading system and inquiry information system. The trading system will not be as effective as designed if it lacks of one of these functions. Trading is only a book-entry, not providing a whole steps including analysis, investment and negotiation.

The combination of stock and bonds trading like Vietnam nowadays will prevent bond transactions from developing, decrease market's liquidity. SSC also has proposed a roadmap for separation of these two markets and chosen the most appropriated trading system: (i) from now to 2010: implication of multi-dealer system which permits only bond dealers to do broking and self-trading (ii) from 2010: introduction of inter-dealer system permit linkages between investors and bond traders, bid and ask prices are available then they can negotiate freely to determine the best price exercised[6].

In fact, the proposal of separation of bond and stock trading has been approved by the Government in June, 2008. However, due to complex and high cost of infrastructure, HASTC has not been applied this trading system yet. Besides that, the fluctuation of VN-index now makes authorities be worried and anxious after 8 years of development. Sooner or later, the separation of bond trading will be took place to improve the liquidity of this market.

Encourage the participation of private institutions in credit rating

In a strong form of efficient financial market, credit rating or bond rating is a standard for investors and issuers to evaluate bond's risk. The policy authority should encourage private institutions not only public ones in collecting and pub-

[6] Nguyen Son, Head of Department of Market Development, SSC, Workshop in VDF in Dec 2007

licizing credit rating and bond rating. It's CIC curently having the priority to be reported by commercial banks about lending and financial situations of their borrowers. Furthermore, these information sometimes are in-creditable and out of date. The participation of private rating institutions will make this sensitive activity more objective and effective. Once privatization, all information will be equal to every investors, asymmetric information and inside transactions will be reduced, investors' confidence will be improved and reinforced.

The model of regional credit rating agency could be implicated in Vietnam, especially in the context of shortage of well-educated human resources in this area. To take advantage of technology and knowledge of the credit rating institutions in the area and worldwide will help Vietnamese ones to improve their own ability. The participation of these institutions is supported by some factors as follows: (i) the fast development of foreign direct investment (FDI) in Vietnam in the next 5 to 10 years, (ii) the prestige of these institutions in the developing finance market like Vietnam. To ensure they will operate effectively, the policy makers also need consider the following conditions: the shareholders are supported to operate independently and prestigiously; the shares must be transferred widely and the maximum holding rate is 5-10% and the balance of the shareholders' holding rate avoids the inside information and managerial conflicts. At that time, not only state-owned agencies but also companies, banks and investment funds can participate to found the credit rating institutions.

Push up the development of market makers

To be said that, commercial banks are targeted to develop as bond market makers in Vietnam besides finance and security companies. In the heated growth of stock market, those candidates were busy with stock trading for benefits or consultant services relating to SOE's IPO. They rarely find out their motivations to be a market maker. It should be issued a legal document to regulate this activity as well as create incentives for market makers. In the context of deeply slowing down of stock market in some recent months, the slowing down of bond market should to be pushed up by market makers.

In some regional markets, the model of bond club is one of the alternative of market makers. Member of bond club will be commercial banks, insurance companies and other institutional investors. They will be shared information, knowledge and experiences in bond investment. They also benefit from promoting relationship as well as an united voice in protecting member's rights when conflicts appear. In Viet nam, bond club is very primarily built up, only in the form of an informal forum for investors, not have been approved by any local authority. Develop this model will help to enhance the foundation of specialized market makers in such a young bond market in Viet nam.

Diversify corporate bonds

At present, there are two main corporate bonds issued: (i) fixed interest rate or interest payment annually (coupon interest rate) and (ii) floating interest rate that means interest rate is flexible depending on market rate. Depends on the real fact of economy, firm will choose each of them. In a stable economy, firm should issue fixed income bonds, that will create a fix income for investors, at that time, both interest rates and bond prices are nearly fixed, the income of investors will have not impacted much on firms' business. On the other hand, when the economy facing with many chaos of macro economics factors, the investors will prefer flexible interest rate. For example, if inflation is high, lead to a drop of real interest rate, the nominal interest rate of bonds will be changed to set off negative impact of high inflation.

When Vietnam economy is integrating strongly in the global economy and influenced more and more by macroeconomic fluctuations in United States and Asian countries, preserve the relative stability of the bond price is important to attract the investors. For example, issuing bonds whose interest rate is secured by gold, or the real interest rate is secured to be always positive when the inflation rate is high. This guarantee will strengthen investors' confidence.

Besides, bonds will become more attractive as convertible bonds or bonds with warrant. Vinaconex issued the bonds with warrant of buying its partner companies' stocks at a favourable price. In fact, this bond's interest is not too high (only 5%) but with the right to buy stocks at the price as much as 1.5 times as par value will help to reduce the PV of bonds.

Firm can also issue convertible bonds that can be converted into stocks after a definite time with a fixed ratio. At that time, their debt will be changed into equity. The bond holders will become the shareholders, can receive the surplus benefit from firms' performances which bond holder could not have. On the other hand, firm will avoid to pay the principal to bond holders because now they become shareholders.

Encourage the participation of investment funds investing in bonds

Nowadays, the investment funds or the mutual companies are developing in Vietnam, with both of direct and indirect investment portfolios. They are active in improving the liquidity of bonds. Not like the market makers, the investment funds collect pieces of capital from non-professional investors and invest in to bond and stock portfolios on behalf of them. At that time, they will be more professional and have more opportunities to approach information, and will have more opportunities to make profit.

According to a survey of World Bank in 2006 (World Bank, 2006), in ASEAN+3 countries, the total value of the bonds which the investment funds holding was from 40% to 60% GDP, while the pension funds from 20%, 30% of GDP and the insurance companies from 5% to 10% of GDP. These figures are "dreaming" in comparision with those of the investment funds in Vietnam. It can be said that it's the active participation of the mutual companies and pension funds which has improved the liquidity of the stock market in general and the bond market in particular.

4. Conclusions

In summarize, the industrialisation in Vietnam puts a pressure on a huge capital demand, the role of corporate bond market could not be denied. However, the bond market in Vietnam is under-developed, although it is the key channel to mobilization long term funds. To encourage this market, it should be considered both from primary market and secondary market approach. The first one relates to policies which helps to encourage firms issue bonds such as flexible interest rate, diversifying types of bonds, determining exactly the cost of equity and cost of debt and promoting the credit rating agencies. The latter one refers to policies which push up the secondary market such as setting up yield curve, developing market makers, encouraging the participation of investment funds to improve the market liquidity.

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