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Research Article

Asymmetric Information in Vietnamese Enterprises: Nature, Cause and Consequence

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Abstract: This study attempts to apply the agency theory in the context of Vietnam by analyzing the nature and causes of information transparency problem in Vietnamese enterprises, particularly the listed ones. We consider that the nature of this problem come from the contradictory interests between principal and agent; its main cause is the asymmetric information between the parties involved, which is favored in the context of separation between the business ownership (of principal) and control (of agent). Profiting this lack of information transparency, the agents shall show their opportunism in seeking their self-interest, thus causing short-term damage in profit and long-term damage in value of the enterprise. To solve this problem, it is necessary that all parties should participate to the management and control of the enterprise on the basis of faithfulness and co-operation.

Keywords: Asymmetric information, conflict of interests, management, opportunism, self-interest, Vietnam

INTRODUCTION

The information transparency problem in Vietnamese economy in general and in its enterprises in particular has been the subject of discussion for many scholars in the country. In recent time, the level of information transparency and announcement has been continuously improved; nevertheless, the information quality has still been far from what investors requested. Typically in the stock market where information transparency serves as its running rule, this conception was still a "luxury" for investors who are habitual the situations where the profitable firm became in loss, or in contrast, firm in loss became profitable in few days after reaudited. As result, firm and market lose investors' and partners' trust and became gradually weakening and falling into an impasse situation, especially when confronted with great changes such as the current financial crisis.

So, it is clear that information transparency problem came from the firm and that is this one which suffers the consequence. The questions posed here for researchers and investors are: why firm fall in the situation of lack of information transparency? What are the nature and cause of this problem? What are the consequences incurred by enterprises and what are solutions to this problem? In answering these questions, this study focuses on the relation between shareholder and manager in the Vietnamese firm on the basis of the agency theory. Agency theory (Ross, 1973; Jensen and Meckling, 1976) emphasizes the interdependent but contradictory relationship between firm owners (shareholders) and firm managers, in which, share holders are referred to as "principal", who mandates managers, known as "agent", to carry out activities of managing their firm in their interests. In fact:

"the relationship of agency is one of the oldest and commonest codified modes of social interaction", *it "…has arisen between two (or more) parties when one*, *designated as the agent*, *acts for*, *on behalf of*, *or as representative for the other*, *designated the principal*, *in a particular domain of decision problems"* (Ross, 1973).

Hence, it can be said that if there be any transfer of the right to make decision, then the agent relationship will exist. Jensen and Meckling (1976) defined also agent relationship as:

"... contract relationships which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, *there is good reason to believe that the agent will not always act in the best interests of the principal"*.

This study aims to clarify the nature and causes of information transparency problem in Vietnamese enterprises. Based on analysis of short-term and long-term financial consequences derived, we will propose some solutions for improving this situation. The study will be structured with three main parts: theoretical

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framework; research methodology of case study; and analysis and discussion of research results.

THEORETICAL FRAMEWORK

By definition, an enterprise means "an economic organization that has its own name, assets, stable office and is duty constituted for the propose of conducting business" (Vietnam Enterprise Law, 2005, article 4). Joint stock or shareholding company is "an enterprise of which charter capital is divided into equal portions known as shares"; in this form, owners of shares or shareholders "are liable for debts and other asset liabilities of the company within amount of capital that they contributed" (Vietnam Enterprise Law 2005, article 77). Therefore, the conception of enterprise has a broader sense; a joint stock company is a form of enterprise that is closely associated with capital ownership of many different individuals and/or organizations. In this study, we focus on the joint stock company which has a natural and clear separation of firm's ownership and control between shareholders and managers. Nevertheless, the results can be applied for similar enterprise forms such as limited Liability Company, holding and even State enterprise if State is regarded as an organizational shareholder.

Conflicts of interests between business managers and shareholders: In an attempt to analyze the origin of information transparency problem in enterprises, we start from the nature of the interdependent but contradictory relationship between enterprise's owners and managers. In reality, the shareholders are the true owners of the enterprise and they have the full right to manage it. However, they "do not want" or "cannot" manage it themselves because of the high transaction and production costs (Coase, 1937; Williamson, 1975), due to resources which are limited and dependent on some other organizations and individuals (Pfeffer and Salancik, 1978) and/or their bounded rationality[1] (Simon, 1961) that make it impossible for them to manage and control the enterprise. Therefore, the owner (principal) shall mandate to manage the enterprise to the agent by employing one or some special agents, known as "general director" ("management board"). The agent has theoretically responsibility to exercise the "ownership right" of owners (now became shareholders), to manage and control the enterprise in the shareholders' interests. This principal-agent relationship between business managers and shareholders is referred to as agency relationship (Ross, 1973; Jensen and Meckling, 1976).

However, this separation between ownership and control will result in the fact that:

"*the directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.* […] *Without an exclusive privilege they have commonly mismanaged the trade. With an exclusive privilege they have both mismanaged and confined it*" (Smith, 1776).

According to agency theory, human tend to maximize his self-interest (Simon, 1961; Williamson, 1975). While the goal of owners (shareholders) is to maximize the returns in the short term and increase enterprise value in the long term, managers seek to maximize their expected utility. As an agent who earns his wages, manager's motives in enterprise include (Williamson, 1963; Simon, 1961):

- The highest salary or income
- Status and prestige involves the manager's position in the enterprise's hierarchy and also closely associated with the firm size and reputation and the manager's favorable working conditions such as luxury facilities and equipment
- Power is closely associated with the manager's role in decision-making process, not simply his hierarchical position in enterprise
- Security and professional excellence involves career safety and promotion chances. Career safety is associated with risks of dismissal, getting the sack as decided by shareholders. Promotion chances imply the manager's position in the organizational hierarchy and favorable conditions for developing his professional potential

In his nature, the agent will give priority to satisfying his objectives rather than shareholders' ones despite the fact that this will induce expenses for the enterprise (Williamson, 1963; Marris, 1963) and also the potential conflicts with the principal. This fact is indeed the source of every problem, including information transparency problematic in enterprise.

Asymmetric information and opportunism: The contractual or agent approach focuses on the commitment of parties in the relationship, particularly in the case of delegation of decision making right between shareholders and managers. Because any relationship is characterized by individuals' seeking of their self-interest, that will incite them to do not respect their commitments. Moreover, in his nature, human beings are intelligent and intendedly rational, despite only limitedly in making decisions, they will prefer cheating more than implementing their commitments, which would reduce their mental, physical interests and time (Simon, 1961; Williamson, 1975). They can also profit their contractual privileges to drive the business in the way that is beneficial to them more than, or even detrimental, to the other. This principle, when applied to the principal as owner, is the profit maximization one, when applied to the agent, is the utility maximization one. These actions above were called by Williamson (1975) as opportunism that: "... refers to a lack of candor or honesty in transactions, to include self-interest seeking with guile". Opportunism is also closely associated with the interests obtained by (a) providing information in an erroneous or selective way or (b) making false or self-disbelieved promises.

In the agency relationship, shareholders delegate the management right of their enterprise to the managers. In other words, they are not directly involved in the business operations, so will not have lot of information about the business. Frequently, they obtain information only when reported (from managers, board of directors and other sources). Even members of Board of Directors may have not information in detail, as they are not directly involved in the micro-control of the enterprise. Hence, there exists the important asymmetric information between principal and agent, which incites the managers' opportunist behaviors to occur, to satisfy their principle of maximizing utility. So, we can conclude that opportunism originates from hiding or cheating intendedly information of the transactional parties. Whereas, the lack of information transparency comes from the asymmetric information between the parties in the transaction.

Two types of opportunism can be distinguished: ex-ante and ex-post one. Ex-ante opportunism of the agent is closely associated with principal's adverse selection when the two parties sign the agency contract; as at this point of time, it is only the agent who can assess exactly his true capacity and usually does not provide the principal with all information. Ex-ante opportunism is closely associated with moral hazard or moral risk of the agent; this occurs when he profit the lack of the principal's monitoring (due to inability or too high transactional costs) to do not carry out correctly his initial commitments (Williamson, 1975). Moral hazard has serious impact on the enterprise, because at this moment, the agent is managing and controlling the enterprise. For example, manager tends to invest in projects which are suitable with his capacity and competency. As the projects will have more likelihood of success, this will strengthen his prestige and status in the enterprise, at the same time increase the transactional cost of replacing him, making it possible for him to claim rise in his income (Shleifer and Vishny, 1989). Also, he will favor the increasing size of the firm, synonymous with the more complexity in the business running and management and in monitoring activities and costs for shareholders.

In conclusion, the nature of the lack of information transparency originates from the contradictory relationships relating to the objectives or interests between the owners and managers. This problem is encouraged in the context of asymmetric information resulted from the separation between business ownership and control. By consequence, manager's opportunist behaviors occur by causing damage to the business. In the following sections, we will analyze some case studies in Vietnam in order to affirm these theoretical points.

METHODOLOGY

Case study method: In this study, we use case study method. The research object is phenomenon of lack of information transparency in Vietnamese enterprises listed in the stock market. This method conforms to the objectives of this exploratory research to analyze and emphasize the separation between shareholders' ownership and managers' information control in joint stock Company in Vietnam.

Following basic steps of a case study recommended by Yin (1984), our research methodology were carried out in six steps, including:

- **Determination and definition the research questions:** On the basis of a literature review on relationships between principal and agent as presented in the first section; and on the basis of the empirical analysis of the phenomenon of lack of information transparency in listed Vietnamese companies.
- **Selecting three cases:** Typical joint stock companies having serious conflicts between shareholders and managers. In order to ensure the confidentiality, we nominate them respectively as the first, second and third company. As data gathering and analysis techniques, we used the event analysis by focusing on company's historical events to clarifying the lack of information transparency as the nature and cause of conflicts between principal and agent and also cause of company's loss.
- **Process of preparing data:** Consists to determine what events and information to be collected. We focused on the stated conflicts, company's reports in shareholder congress and its business events.
- **Collecting data:** concentrated so on press releases, disclosed events relating to the business, as well as financial reports of the company.
- **Processing and analyzing:** the data collected basing on logic chain of company's events.
- Editing the paper.

Case study summary:

- **Enterprise 1:**
  - **Overview:** Enterprise 1 is a joint stock company. Its greatest shareholder is the Vietnamese State with 30% of company's capital (represented by a State enterprise); 40% of its capital is holed by internal shareholders. Enterprise 1 was one of the leaders in its sector of medical cotton, cotton sanitation, cotton swabs and other products made

of cotton. In 2000, medical cotton products of the company occupy 90% of market share in Vietnam; advanced sanitation and cotton sanitation also account for 30% of Vietnamese market. But problems imply mainly in the company's business process and its financial transparency.

- **Key events:** In 2004, annual financial report of the company showed a loss of VND 2.121 billion. In the two years of 2005 and 2006, its audited financial report indicated after-tax profits; however, many important items were excluded. In October 2007, the after-tax results for 2006 were approved and reaudited, revealing a loss of VND 8.448 billion; re-audit of financial report in 2007 indicated also a loss of VND 6,809 billion. In 2008, the company continued to be in loss of VND 11 billion. Its business was suspended on 12th July 2008; the company was excluded on stock market in August 2009. On 19th February 2009, the third extraordinary shareholders' meeting dismissed the Board of Directors and set up a new management board. In 2010, the company restarted its business and achieved the revenue of VND 27 billion, but still lost VND 18.94 billion.

- **Enterprise 2:**
  - **Overview:** Enterprise 2 operates in the sector of construction and real estate; starting as a joint stock company with over 36.3% of the capital owned belonging to a State construction group, 36.15% belonging to other domestic organizations and individuals, 26.92 belonging to foreign organizations and individuals. Conflicts occurred mainly between the State shareholders and the leadership including representative of State shareholder in board of Directors of the enterprise 2.
  - **Major events:** Since its foundation in 2001, the enterprise 2 has had four times changing its General Director and whilst their 5-year tenure did not expire yet; the State shareholders of the enterprise 2 have had three times dismissing, withdrawing their member as President of Board of Directors. Recently, at the shareholders' meeting on 30/06/2012, Board of Directors and the Monitoring Committee, which had been elected just a couple of months before, were re-elected again. The conflicts between the shareholders and the management board had needed police's intervention when the former director refused to give up their positions and the enterprise's stamp. Such contradictions constituted part of the cause leading the enterprise's loss of over VND 46 billion in 2011, whereas in 2010, the enterprise gained a profit of VND 456 billion.

- **Enterprise 3:**
  - **Overview:** The scope of business of joint-stock company 3 is transportation; 30% of its capital was occupied by a State enterprise; the company's personal account for nearly 40% and the remainder is outside shareholders. During the period 2006-2010, this company suffered continual losses, uncertainty in terms of organization, production and commercial business as resulted from conflicts and faults committed by its management board.
  - **Major event:** In June 2008, a group of shareholders accounting for over 40% of the total shares did not acknowledge the title of President of Board of Directors who is also the General Director of the enterprise because of faults committed by the his management board. In 2008, the enterprise had three times convened the shareholders' meeting; in which over 80% of them voted for dismissal of the actual management board, but no agreement reached when voting new board of directors and monitoring committee. Until in the end of 2009, a new management board of the company could be legally founded.

RESEARCH RESULTS

The case study examples above clearly indicate intentional actions of managers that cause information transparency problem in order to seek their self-interests. In Enterprise 1, despite the auditing companies' recommendation concerning the important items excluded, the company's management board not only failed to make adjustments but continued to record intendedly wrong sales revenue, wrong debts … during many years in the annual financial reports. They even intendedly provided wrong data by colluding with some auditing company in order to make "virtual" profits in the company's financial reports. The same things happened at Enterprise 3 when the President of Board of Directors cum General Director on his own initiative drew up virtual contracts with some organizations and individuals to borrow money and/or distribute money of the company; for example, his "joining efforts" with a social association for concealing VND 100 million from the enterprise's budget; without entering into the account part of an real estate contract; signing contracts "without payment" worth up to VND 700 million.

Thus, it is obvious that the nature of information transparency problem in enterprises originates from contradictions in terms of objectives and interests between shareholders and managers. This has been clarified by manager's actions of making use of information asymmetry, resulted from the separation between ownership and control, to maximize their utility. We continue to analyze in detail:

- The real objectives of managers when they intendedly create the context of information asymmetric
- His actions of self-seeking profit according the agency theory

First, in order to achieve their objectives of wage, powers, reputation and professional promotion, managers often do not maximize the company's profit, but tend to maximize sales revenue (Baumol, 1959). The literature on agency theory have pointed out that manager's interests are closely associated with the enterprise's sales revenue as following:

- Manager's wage and bonuses are often more closely associated with sales revenue than with profit that is in shareholders' own right
- High sales revenue is synonymous with larger market share of the enterprise. Larger market share will guarantee the manager's position, powers in the enterprise. On the other hand, the enterprise's market share larger enough will reduce competition, business risks from that to weaken competition pressure, uncertainty, to improve sustainable corporate development; this is synonymous with a higher level of the manager's career safety
- High sales revenue will enhance the manager's prestige in the enterprise and on the labor market. In reality, manager's capacity is often judged basing on sales revenue rather than on profit of the enterprise; for example, banks and financial institutions usually pay special attention to sales revenue and its fluctuation when according loans. Large sales revenue and high growth rate are also closely associated with large-scale production, corresponding to a great number of personals that is proportional with manager's powers

Second, according to Williamson (1963), manager has great discretionary rights and takes control over some expenses, thereby enabling the manager to satisfy his personal objectives in terms of income, reputation, powers and professional promotion. The three kinds of expenses incurred for enterprise under the agent's management include:

Staff expenses: Relate to the number of staff, particularly administrative ones and their average wage. Managers frequently are motivated to increase the staff number and improve the quality of their staffs by resulting corporate expenses. A typical example is in the case of Enterprise 1, payment for the General Director's income went beyond the limitation meanwhile the company was suffering losses. In reality, the management of a considerable number of staffs serves as ground for exercising powers and prestige of the manager. Sometime, agreat staff numberisalso considered as:

- A measure of success for decisions made by the manager
- An indicator of the company's ability to survive and develop in the future. At the same time, the opportunity of promoting for managers in general in the enterprise will be higher due to the respective growth of management positions

Emoluments: A discretionary is part of the manager's income; it relates to financially preferential bonuses like non-interest loans or loans at low interest rates, non-financial bonuses like luxurious equipment and facilities, expensive means of transport… For example of construction projects of Enterprise 1, many considerable expenses have incurred for project managers' entertainments, inviting their friends and travelling. In reality, such expenses will increase the manager's utility, but they are not part of their management wage resulted from their managing capacity; but these expenditures contribute to confirming their position, powers and reputation in and outside their enterprise. Emoluments, if limited or removed, will not have impact enough on the manager that drive him to seek another job; also, they are not as attractive as other salary and bonuses due to their limited scope of use (e.g., luxurious offices are just in enterprise and during working time). Nevertheless, this utility has its advantage in that it is rarely subject to tax as well as control by shareholders, who usually focuses on managers' official wage and bonus.

Discretionary capital expenditures: they are expenditures excluding investment ones that create company's profits. Such expenditures are mainly for projects serving manager' self-interests such as activities of supporting, sponsorship, charity, donation… For example, President of Board of Directors cum General Director of Enterprise 3 on his own initiative drew up some virtual contract with a social association in "concealing" VND 100 million from the enterprise's budget.

The next factor that enables the manager to obtain his objectives of reputation, powers and professional safety is to develop the enterprise in "his empire" as large group or corporation. Marris (1963) indicate that the manager (agent) has a taste for empire-building. However, such development need great capital investment and face to considerable business risks in the short and long term thus may cause damages to shareholders, who are only interested in profitability of the capital (shares) they owned.

As mentioned in case studies above, manager's self-seeking of interest may have negative impacts on the company's business in term of expenditures resulted (Jensen and Meckling, 1976). According to agency theory, such expenditures include:

Monitoring expenditures derived from shareholders: Including expenditures for seeking information, monitoring agent in order to ensure that agent manages and controls the business in principal's interests and according the policies, orientations envisaged by them. Through all the three case studies analyzed, these expenditures related to organizing several shareholders' meetings in a short period and also expenses incurred and efforts made by shareholders.

Bonding expenditures derived from manager's engagement actions: including expenditures for making reports, declaration in order to ensure shareholders that their actions shall be executed as engaged. These expenditures can be in the form of compensation in the case the manager fails to exercise or finish their committed obligations. For example in Enterprise 1, we could observe that the expenditures which the management board has to pay for cheating, adjusting information are considerable.

Residual loss: Including opportunism expenditures corresponding to the losses incurred by the two parties respectively if they do not engage together in the firm's business. Through the examples above, these expenditures are most clear for shareholders of all three firms: if they manage themselves the firms without managers, the business might not have been in such situation above. However, as mentioned in the theoretical framework, shareholders did not desire or they were unable to manage the firm, thereby they had to accept these residual expenditures. For managers, the residual loss involve in the fact that they might earn more if they work in other firm.

The mentioned expenditures and activities from which they derive for each party (principal and agent) in their agency relationship create a specific government form of joint stock companies: the agent pursues his principle of maximizing utility in the obligation to satisfy the principal's minimum requirements, for example in term of profit and dividend. This argument has already been pointed out in agency theory, but it seems to be ignored by managers in Vietnamese joint stock companies. As consequence of shareholders' unsatisfaction, the management board was dismissal, replaced in the three example firms above.

CONCLUSION

From the theoretical and empirical analyses, we can observed that the nature of information transparency problem reside in the contradictory interests between shareholders and managers, in which we must emphasize the manager's action of seeking to maximize utility. The cause of this phenomenon originates from the separation between the principal's ownership and agent's control: the managers were delegated the full right to lead and manage the business under but limited control of shareholders. It is in this context that the information difference between the parties occurs by making favorable conditions for managers' opportunist behaviors and actions of cheating and/or hiding information in order to satisfy their objectives of remuneration, reputation, powers and professional promotion. As consequence, the shareholders have to suffer damages in terms of dividend in the short term and firm value in the long term.

This research involves some contributions, particularly for business management in emerging countries such as Vietnam. Firstly, shareholders should shape transparent policies at the beginning in signing delegation contracts with agent, selecting capable and experienced agent who act voluntarily on behalf of the firm, by according to them a suitable wage in order to encourage them to well fulfill their rights and obligations. Policies on rewards and penalty also play an important role, for example, financial bonuses should be attached proportionally with firm's net turnover or profit. Such measures will limit agent's wasting expenditures that can be cut down such as expenses for entertainment, sponsorship, office facilities, travel.

Secondly, the most important involves the principal's role in supervision system, at least major shareholders; because firm's interests are closely associated with their ones, for example by selecting auditing company. Nevertheless, special attention must be drawn to the fact that information transparency problem could not be solved when one or some shareholders participate in the management board. Because if shareholder-manager has more information (as being a shareholder and a manager, too), his behavior also follow the principle of maximizing his interests: he would select a position for him basing on the comparison between the interests obtained as shareholder and the interests obtained as manager; and in some time with the interests obtained by his combined position in the firm. For maximizing his self-interests, the shareholder-manager tends also to cheat and/or hide information.

Thirdly, there should be straightforward information exchanges between shareholders by building a co-operation relationship for mutual and collective benefits of the enterprise in short and long term.

Besides the solutions from enterprises, the Vietnamese government plays also an important role by completing the legislative system including information proclamation and management process to meet international standards and closer to firm situation. The State shall strengthen auditing activities, complete accounting regime and expand the application of international standards for accounting, audit and financial reports.

Through this research in Vietnam, we had clarified the nature of information transparency problem that reside in the contradictory interests between principal and agent; its main cause is the asymmetric information between the parties involved, which is favored in the context of separation between the business ownership (of principal) and control (of agent). Profiting this lack of information transparency, the agents shall show their opportunism in seeking their self-interest, thus causing short-term damage in profit and long-term damage in value of the enterprise. We hope that the theoretical and managerial results of this research could contribute to improve management performance in Vietnamese enterprises.

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End notes:

1: "boundedly rational agents experience limits in formulating and solving complex problems and in processing (receiving, storing, retrieving, transmitting) information" (Williamson, 1981, p. 553, quoting Simon)