STUDYING FLOWS OF FUNDS OF BUSINESSES AS A WAY TO SUPERVISE LOANS SUPPLIED

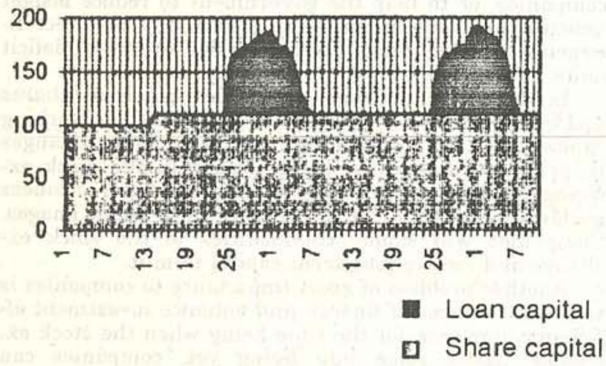
by VŨ NGỌC NHUNG

Flows of funds of a business have their own laws. In businesses with seasonal operation such as agro-industrial factories, their flows of funds also have seasonal features, so these businesses can get some loans and repay them at the end of the season. At present, regulations on supply of short-term loans enclosed with the Decision 198-QĐ/NH1 issued on Sep. 16,1997 by the State Bank Governor divided businesses into two groups:

- Businesses with regular demand for loan capital.
- Businesses with irregular demand for loan capital.

In businesses of the first group, loan capital can be found in raw materials in stock, unfinished products and stock-in-trade. In foreign countries, these businesses can easily get advances on current account from banks. In order to be of better service to customers, foreign banks usually supply a wide variety of loans appropriate to different types of cash flows:

(a) Banks can supply credit facility up to an agreed sum to companies with large share capital (these companies need some loan capital that is equal only to 10% of their working capital). These companies usually want to borrow at the month's end in order to pay bills or pay wages and salaries, so the bank needs only to supply more than the amount standing to companies' credit in their current accounts, that is, to allow companies to run into debt in last weeks of the month. This credit facility could be shown in the following graph:



(b) Bank overdraft: to companies with good performance or with small share capital (equalling around 50% or 60% of their demand for working capital), banks can set a credit limit, or offer overdraft facilities to companies. These companies can withdraw from bank accounts a sum of money which is more than there is in accounts in order to buy raw materials and other goods and make repayment when they sell out finished products. Businesses must see to it that the balance of their accounts keeps on changing but the debit balance never exceeds overdraft facilities.

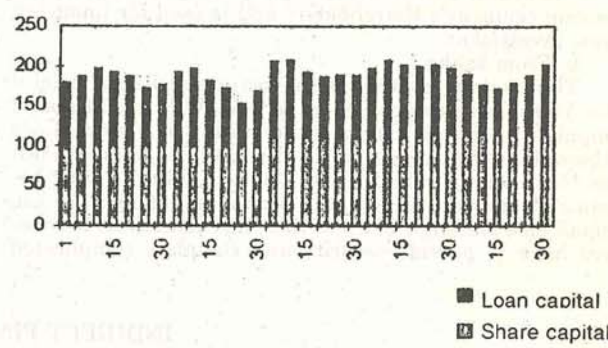
In the subsidized economy in the past, bank overdraft used to be called "advance on current account" supplied to state trading companies, or "loans against working capital" supplied to state industrial companies.

Companies with regular demand for loan capital tend to be permanently in debt to banks, that is, their bank accounts always show a debit balance.

As for companies with irregular demand for loan capital, there will be two problems:

1. Term of loans

In the past subsidized economy, state trading companies were supplied with advances on current account and there were two views on this kind of loan:



Flow of funds of a company with regular demand for loan capital.

(1) One opinion considered this kind of loan as rollover loan because it can be renewed automatically after a length of time (one year for example) and the debit balance keeps on changing according to company's operation.

(2) Another opinion suggested that this loan could be turned into time loan and the term of loan could be arranged according to company's capital turnover.

The second opinion is more reasonable and could help to supervise company performance, therefore it was included in regulations on supply of loans adopted by the State Bank, however, to arrange term of loan according to company's capital turnover is a difficult and complicated task, and as a result, most bank clerks were reluctant to do it and many bank managers weren't willing to offer this kind of loan.

2. How to supervise loans to companies and repayments?

To make use of bank overdraft, or to get bank loans, companies can pay their suppliers by personal cheque, bearer cheque or order for payment. When selling goods, companies can have their customers make payment in cash or by cheque to their bank accounts. Banking regulators, for fear that in case of dispute, these cheques and orders for payment aren't accepted as documents of loans received, have made regulations requiring customers to endorse them, so at many banks, these documents are used for proving changes in customer's debit balance.

It's not difficult to solve this problem. Banking regulators can rule that all cheques and orders for payment drawn by customers will be considered as proof of loans received, and all payments (in cash or by cheque) made to customer's current account will be considered as repayments of debt. In the past, regulations have required customers to write down *"loans received"* on the back of documents issued by them.

Current regulations on supply of loans set forth by the Decision 198-Q9/NH1 issued on Sep.16,1994 by the State Bank Governor referred to day-to-day loans but avoided mentioning advance on current account (perhaps Russian textbooks said that advances on current account could be only supplied to state companies with good performance). Many bank managers also thought that these advances involved a high degree of risk, or made things very easy for companies, so they tended to avoid offering this kind of loan.

The Article 8 of the above-mentioned Decision 198-QĐ/NH1, referring the term of day-to-day loans, reads as follows:

"Decision on the term of loan should be based on business cycle or capital turnover of borrowers. If borrowers get loans and repay on a regular basis (monthly, quarterly or yearly), the loan will be repayable by an agreed number of instalments appropriate to borrower's capital turnover and limites on the number of instalments".

This is a scientific method of deciding on the term of loan which can encourage borrowers to make the best use of loans received. Let's take an example: sales of a business in a year totalled 12 billion and its share capital was turned over 4 times during the year, thus the term of loan will be of three months. Because of the limit on the number of instalments, the business must repay some 3 billion on a quarterly basis depending on fluctuations in the market: its sales could reach 4 billion in the first quarter because of the Tết Holidays or reduce to 2.5 billion in the second quarter. If it can only repay 2.2 billion in the second quarter instead of 2.5 billion, the bank can save it from making interest payment on the difference of 300 million when the business proves that there is a fall in spending power in the second quarter.

This method certainly doesn't force businesses to limit or reduce their production and sales in order to repay all debts before securing new loans. If they don't want to reduce production they have to look for some short money at a high interest rate in order to repay bank loans. After that, if the bank refuses to supply new loans, the business will be in financial difficulties, suffer losses or go bankrupt because it fails to maintain regular operation.

Refinancing of a loan (with no reduction of interest rate) is a headache to banks because it is forbidden by banking regulations. If the bank prevents borrowers from refinancing their loans, borrowers will meet with a lot of difficulties. Many bank managers have to have their counterparts in other banks supply new loans to their customers but this practice will be easily discovered by banking supervisors. So supplying advances on current account is a solution to this problem which allows the bank to learn how their customers use these loans. This solution also helps the bank cooperate with businesses to solve financial difficulties. As for businesses, they had better not avoid receiving advances on current account for fear of disclosuring their sales.

In my opinion, banking authorities had better study this problem carefully in order to take a reasonable view on the advance on current account. A false impression of this kind of loan has prevented our banking system from integrating into the international banking business and forced Vietnam ese banks to violate banking regulations unwillingly■