

FOR A BETTER PERFORMANCE OF



AFTER PRIVATIZATION

by TRỊNH ĐOÀN TUẤN LINH*

Vietinbank is a major bank in Vietnam with a network covering all provinces and cities. It has made good progress after privatization but also face keen competition from both foreign-invested and local banking institutions. That is why Vietinbank considers improvements in its business performance a priority in its effort to survive the competition and develop in years to come. This paper tries to identify factors that affect performance of commercial banks in general, and estimate Vietinbank performance before the privatization based on CAMELS model. the last section of the paper offers some measures to improve its performance after its privatization with a proper emphasis on its shortcomings in the past, such as failure to employ its resources properly and dependence on traditional services.

Keywords: business performance, privatization, human resource, banking services

Vietnam Joint Stock Commercial Bank for Industry and Trade, or Vietinbank, former Bank for Industry and Commerce of Vietnam, was established as Bank Specialized in Industry and Commerce by Decision 53/HĐBT made by the Council of Ministers on March 26, 1988.

On July 7, 2009, SBV issued Decision 14/GP-NHNN on establishment and operation of the Joint Stock Commercial Bank for Industry and Trade.

After some 20 years, Vietinbank has become a multi-functional bank with a network covering 60 provinces and cities comprising a head office, one transaction center, 149 branches, over 800 transaction and savings offices, five representative offices, four subsidiaries, three administrative units and 1,042 Automatic Telling Machines (ATMs), and has established correspondent relationship with 850 banks, financial institutions in 90 countries and territories all over the world.

In recent years, especially after Vietnam's accession to the WTO, challenges posed by international integration have attracted great attention from both local and foreign organizations. Competition and challenges have reached an unprecedented level. Commercial banks – financial intermediaries that play an important role in the economy – are facing an increasing competition from non-banking institutions and foreign banks as well.

Although the reform and restructuring of the system of banks for industry and trade since 2000 have improved considerably their scope and quality, shortcomings and difficulties still existed. Facing a competitive climate and great challenges from the economic integration, Vietinbank has to not only maintain its operations but also improve its competition against non-banking and various financial institutions. To achieve this aim, Vietinbank should enhance its business performance.

This paper discusses factors that affect business performance of commercial banks in general, and estimation of Vietinbank performance before its privatization based on CAMELS model, thereby offering measures to improve its perform-

* VietinBank

ance after the privatization.

1. Factors affecting performance of commercial banks

Commercial banks always face difficulties and challenges on their way to development. Each bank tries its best to ensure its competitive edge and sustainable development. To gain good performance, however, commercial banks should identify factors that influence their operations in order to limit risky activities, preserve their capital and increase their profit.

a. Socioeconomic and political climate:

A stable socioeconomic and political climate will facilitate operations of commercial banks because it is a condition for economic development, corporate ability to use capital effectively and make repayment of debt, and reduction in risks. On the other hand, an unstable climate creates unfavorable changes, such as lower demand for capital, bigger volume of bad and overdue debt, and lower need for banking services, which damages business performance of commercial banks.

b. Legal climate:

This climate includes all conditions established by laws in which governmental and private organizations and individuals carry out their operations and interact with one another. In a broad sense,

the legal climate includes a system of laws, interpretation of laws, law enforcement and awareness of laws by citizens.

A favorable legal climate reflects itself in consistency and perfection of laws and the bulk of subordinate legislation. If the law system is not appropriate to the demand for development of the economy, it will become a hindrance to economic development.

c. Financial strength: Banks can only achieve good performance when their financial strength is firm enough.

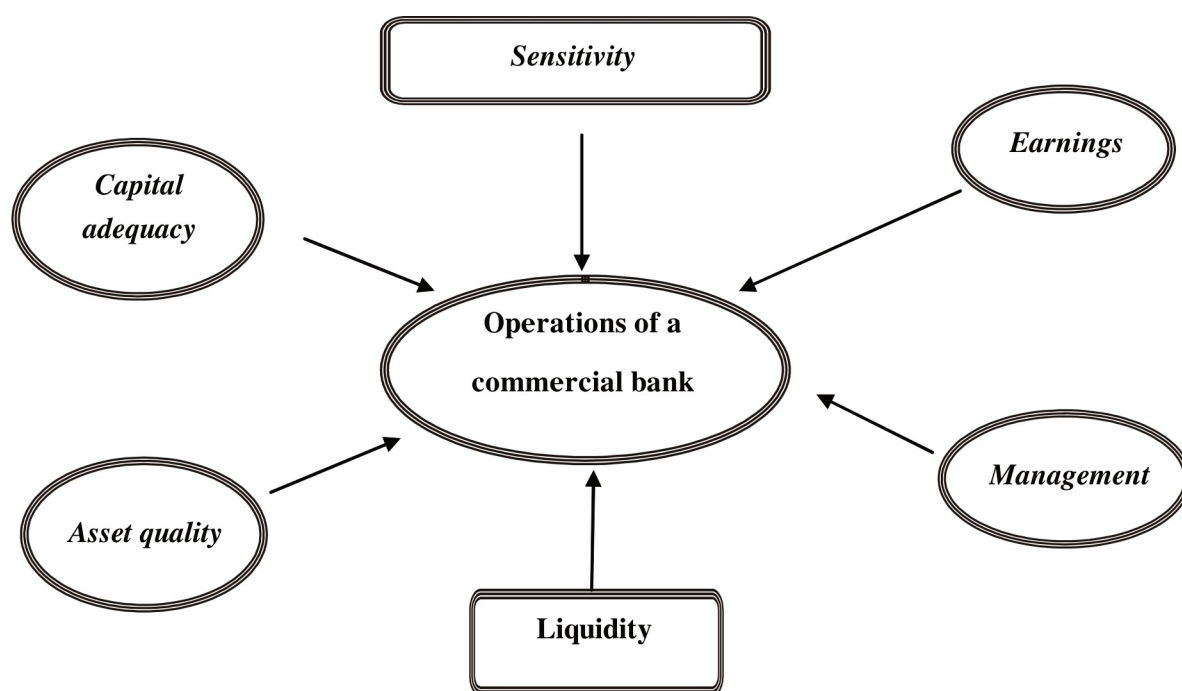
The most important part of the financial strength of a bank comprises its chartered capital and reserves. Its capital is a guarantee for customers' deposits and used for dealing with risks and ensuring the bank solvency.

The financial strength of a bank reflects itself in its ability to increase its equity capital. This source of finance affects its scope of business in terms of borrowing and lending services, financial investment and technological facilities.

d. Managerial skills: These skills show themselves in organization of governing machinery, management ability and efficiency of the machinery in achieving planned targets.

e. Technological application: This aspect

Figure 1: CAMELS elements of operations of a bank



implies ability to apply IT to banking operations and includes ability to use new technologies, and efficiency and cooperation in technological application of a bank.

f. Human resource: Quality of the human resource reflects itself in personnel policy, ability to attract and employ well-trained laborers and develop the talented. At present, success and failure of a bank is determined mainly by the human resource, especially in such developing countries as Vietnam.

2. Estimation of the Vietinbank performance by CAMELS model

The CAMELS rating system is a method of evaluating the operations and risks of banks according to international standards. The rating is based upon six critical elements of operations of a bank: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk.

To most banks, this system has been very familiar because it is the development model for most commercial banks in the world and an inevitable trend for commercial banks in Vietnam.

a. Capital adequacy: Before July 3, 2009, Vietinbank was a state-owned commercial bank. Its capital came from investments from the State and retained profit. After July 3, 2009, it became a joint stock commercial bank where the State held 89.23% of equity capital and the rest held by other shareholders. In three years before its privatization, its capital increased remarkably, from VND5,636 billion at the end of 2006 to 10,646 billion on Dec. 31, 2007 and 12,336 billion on Dec. 31, 2008.

In doing their business, banks should ensure its capital adequacy ratio (CAR). It is an important indicator of the financial strength of a bank

$$CAR = [(Tier\ 1\ capital + Tier\ 2\ capital) / (risk-adjusted\ assets)] * 100\%$$

According to Article 4 in the Circular 13/2010/TT-NHNN dated May 20, 2010 issued by the SBV Governor (on ratios of safety observed by banking institutions), all banking institutions, except branches of foreign banks, should keep a minimum CAR of 9%.

The Vietinbank CAR rose from 5.18 in 2006 to 11.62 in 2007 and 12.02 in 2008 (calculation of this ratio is based on the said Circular). This ratio

of Vietinbank up till now, however, is still smaller than those found in other banks.

b. Asset quality: Vietinbank asset has increased strongly in recent years along with the growth of the banking system. From 2006 to 2008, its assets rose from VND135,442 billion to 193,591 billion increasing by 42.93%. The best part of this growth came from the increase in loan supplied, from VND80,152 billion in 2006 to 120,752 billion in 2008.

Outstanding loan always accounts for the biggest share in the total assets. This share varied from 59.18% in 2006 to 61.52% in 2007 and 62.37% in 2008. This growth rate was high in comparison with other banks.

Bad debt ratio in Vietinbank was 1.41% in 2006; 2.3% in 2007 and 1.82% in 2008. These figures show that the bad debt is well controlled as required by banking regulations. The ratio, however, is still high as compared with other banks.

c. Management: Vietinbank has step by step applied international standards to its operations, such as employing international auditing services to check annual financial statement, and learning modern banking operations. In addition, annual training courses in managerial skills are given to managers.

Most leaders of Vietinbank, however, are old and lack intensive training, and as a result, they tend to do their business according to their experience and fail to absorb new knowledge and develop their creativity. Leading positions are usually determined by appointments from its governing body instead of examinations. This seniority-based promotion mechanism makes the managerial machinery in Vietinbank less flexible and creative, and its staff less professional, which affects badly its business performance.

d. Earnings: Vietinbank business performance has been improved over years. Its pre-tax profit in 2006 was VND829,991 million and rose to 1,529,085 million in 2007 increasing by 84.23%, and 2,436,388 million in 2008 increasing by 59.33%.

**Table 1: Indicators of Vietinbank profitability in
2006 – 2008 (VND million)**

Indicator	2006	2007	2008
After-tax profit	602,800	1,149,442	1,804,464
Ratio of pre-tax profit to average total assets	0.66%	1.01%	1.35%
Ratio of pre-tax profit to equity capital	15.61%	18.38%	21.20%
Ratio of pre-tax profit to sales	18.11%	23.00%	28.02%
Ratio of after-tax profit to sales	13.19%	17.29%	20.75%

Source: Vietinbank annual reports from 2006 to 2008

These indicators showed an upward tendency over years but they are low in comparison with those found in other banks.

The ratio of after-tax profit to average total assets in 2006 and 2007 was smaller than 1% while this ratio of other banks varied between 1% and 2%. This shows that Vietinbank has to make greater effort although its performance has been improved to a certain extent.

Income for Vietinbank comes mainly from lending service. Ratio of income from interest and its equivalent to total income was 77.55%; 70.44% and 82.69% for 2006, 2007 and 2008 respectively. Share of income from other services in total income is still small in comparison with other joint stock commercial banks. It was 5.96% in 2006; 5.03% in 2007 and 5.04% in 2008.

Steadily increasing profit of Vietinbank is an encouraging sign that reflects great efforts by the leadership and employees but its profitability ratio is low as compared with other banks. Heavy dependence on lending service makes Vietinbank face more risks because risk management cannot keep abreast of enlarged operations.

e. Liquidity:

Vietinbank always observes banking regulations about liquidity management. Large volume of cash and instruments from money market ensures good liquidity for Vietinbank although its liquidity is still low in comparison with other banks.

At present, Vietinbank controls its liquidity by calculating payout ratios according to SBV instructions and sending regular reports to the SBV. To ensure high liquidity and avoid unexpected inci-

dents, Vietinbank deposits a rational ratio of assets in cash and cash-equivalent assets, nostro accounts, instruments from money market and special reserves with the SBV. In urgent cases, Vietinbank can ask for help from the SBV and other banks.

3. Measures to improve the Vietinbank performance after privatization

The above analyses show that Vietinbank failed to employ its resources effectively. In spite of its large market share, Vietinbank still depends heavily on traditional services. To improve its performance and competitiveness in its process of integrating into the world market, Vietinbank should beef up its operations in the following directions.

a. Managerial skills:

In reforming its organization, Vietinbank should manage its operations based on groups of customers and services of a multi-functional bank instead of functions of each department. Fuller attention must be paid to management of risks, assets and liabilities; and internal control in order to create a basis for a strong financial group and commercial bank of international standards.

Delegation of rights and duties is necessary to enhance its service quality and ensure its future development. This is also a model common among the world leading banks.

b. Staff:

Its workforce should be reviewed and re-assessed in terms of age, expertise, and education in order to classify its employees and work out appropriate training programs. This effort aims at improving the quality of its human resource and dealing with shortage of skilled and well-trained laborers.

Training program is an indispensable part of the development strategy. This program must be carried out right after recruitment to enhance both expertise and work ethics of employees. Training the human resource should be linked with re-training for all employees in preparation for new requirements.

A training program in Vietinbank should aim at improving necessary skills needed for modern banking services. Moreover, it should also help standardize Vietinbank officials in charge of international integration, especially the ones engag-

ing in international negotiations, international legal matters, signing of contracts, supervision and investigation, and application of new technologies. Policies on bonus and salary should be rational in order to attract well-trained laborers and encourage employees to improve their performance.

c. Modernization and diversification of banking services:

Although Vietinbank has increased its investment in the IT, contribution to business performance is still limited and the Vietinbank IT system is considered as weak. One of major causes is failure of its departments to deploy new electronic services and employ IT effectively. Moreover, Vietinbank employees lack necessary expertise to master new technologies and electronic services and make the most of the IT system.

At present, supply of services by Vietinbank has not been developed well. Its profit is mainly from traditional services that are facing keen competition from other banks, which makes it difficult to improve its business performance. The competition tends to contract differences between lending and borrowing rates. To improve its business performance, Vietinbank should enhance quality of traditional services, and at the same time, accelerate modernization and apply new technologies effectively to development of new lines of products and services to beef up its competitiveness, and exploit cross-selling service to offer more choices to customers. Differentiation of products, moreover, can help distribute and reduce risks in its operations.

In developing new banking services, Vietinbank had better engage in e-banking business to ensure 24/7 service for customer, thereby reducing costly building of branches and waste of labor.

d. Customer strategy and diversification of products:

- The customer strategy should aim at creating, maintaining and developing good relations with all customers, especially ones with good track records.

- Network of branches should be developed without enlarging the organizational machinery and staff. It should be linked with development of auto-banking service based on ATM and IT.

- Products and services supplied must be differ-

entiated and upgraded while complicated procedures must be simplified.

- Ways of attracting deposits must be diversified and linked with technology-based services, such as Internet banking, mobil-banking, and phone banking. Interest rates should be also as diverse as ways of attracting deposits, and customers are allowed to change easily their classes of deposits. In addition, retail banking services must be developed stronger in order to establish a flexible process of supplying banking products. Preferential rate of interests could be offered to potential customers

- When traditional services face lower return to scale, Vietinbank should make the best use of existing facilities to expand its market share to serve local customers, including such service as monitoring and making wage payments for companies with a view to making banking services more convenient■

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