

# SOME SOLUTIONS TO SECURE VIETNAM'S SYSTEM OF COMMERCIAL BANKS

by Dr. NGUYỄN ĐĂNG DỜN & ĐĂNG VĂN QUANG

After 10 years of reforming the finance system, our country have established a system of second-level banks, mainly commercial banks. In the system, the state-owned commercial banks play a leading role. The banks have contributed greatly to the implementation of socio-economic targets and the national industrialization and modernization.

To date, the Vietnam's system of second-level banks include:

- 4 state-owned commercial banks:

The Vietnam Bank for Agriculture and Rural Development with 1,250 branches nation-wide and chartered capital of VND2,200 billion.

The Vietnam Bank for Industry and Commerce with 20 branches and chartered capital of VND1,100 billion.

The Vietnam Bank for Foreign Trade with 20 branches and chartered capital of VND1,100 billion.

The Vietnam Bank for Investment and Development with 61 branches and chartered capital of VND1,100 billion.

The Vietnam's commercial banks have reputation both in local and foreign markets. Each of them has business relations with hundreds of banks in the world.

In addition, there are also other banks such as Bank for the Poor, Bank

for Housing Development in the Mekong Delta.

54 joint stock commercial banks with hundreds of branches (34 in urban area and 20 in rural one).

2 finance companies.

4 joint venture banks.  
24 branches of foreign banks.

911 local people's credit funds, 8 regional

3-month, 6-month, 1-year, 2-year, and 3-year deposits:

- Savings deposits in local and foreign currencies.

- Savings deposits with value guaranteed by gold.

- Banks' bills in local and foreign currencies.

- Banks' bonds.

- Savings deposits for housing development.

## Lending

The proportion of lending varied among economic sectors

In the subsidization period, the banks offered 90% of their credits to state-controlled firms, 10% to cooperatives and 0% to private sector. Nevertheless, the lending changed basically in 1991-

	1990	1991	1992	1993	1994	1995
Loans to state firms	81%	90%	81%	65%	64%	57%
Loans to non-state firms	19%	10%	19%	35%	36%	43%

ones and 1 central one.

In our opinion, the number of these banks and credit institutions is appropriate to the economy. However, it is better to set up more finance companies, people's credit

These deposits have different interest rates including inflation rates to lure the public to put their money in the bank,

The capital mobilization from the population saw an upward tendency,

1995 as follows:

Changes in loan structure: Previously, short-term loans accounted for 95% of the total outstanding debts, but in recent years, the proportion dropped sharply:

	1990	1991	1992	1993	1994	1995
Short-term loans	95%	85%	83%	77%	67%	69%
Medium-term loans	5%	2%	4%	14%	18%	24%
Long-term loans		13%	13%	9%	15%	7%

funds and leasing companies.

The service quality of the system of commercial banks in Vietnam is not high and remains many deficiencies which need careful analysis and practical solutions.

## Capital mobilization

These commercial banks have launched many various forms to attract money from the population such as demand deposits,

reaching from VND2,000 billion in 1986, 1987 and 1988 to VND17,000 billion in 1995. In 1997 it increased 15.7% over 1996.

The banks' capital mobilization has made significant progress and drawn the people's idle money. This has reduced the pressure of inflation while created a great supply of credits to the economy, amounting to VND100,000 billion.

## GENERAL EVALUATION OF COMMERCIAL BANKS' OPERATIONS

### Achievements:

The banking system has attained achievements by diversifying its services in urban and rural area, serving production and business and the country's economic growth.

The Government's policy on capital mobilization gained the public trust so

they were willing to deposit their money into the bank. Apart from this, the banks have spread branches and applied appropriate interest rates and their working style satisfied the depositors.

- The banks have invested their money in production and business development, step by step increased their profits and paid large amounts of taxes to the Treasury. Their investment showed many good signs as follows:

- Capital investment soared fast, proving the economic growth.

- Investment structure changed significantly, medium- and long-term loans rose faster than short-term loans, helping many enterprises expand their production, innovate technologies, improve product quality and raise their competitiveness on the market.

- The state-owned commercial banks were playing a leading role in investments for the economy, accounting for 80% of the total outstanding loans.

- Many banks have taken initiative in seeking clients and markets for their investment and their management level indicated good progress.

- The supervision and settle with violations of banking regulations have been strengthened.

- The Government's macro-level policies have been adjusted to suit them selves to the changes of the market, creating favorable conditions for the banks to operate effectively.

#### Shortcomings

- The legal framework did not yet secure fair opportunities among sectors in competition.

In fact, the state-owned banks enjoyed many comparative advantages such as rediscount lending, guarantee for borrowing foreign loans, staff training... The State Bank often

gave them more priorities.

The legal system was not sufficient and uniform. The regulations on lending showed confusion, especially in collateralization, sales of mortgages, compensation for credit risks... These are hurdles to the banking system's safety and the stability of the economy.

- Capital mobilization has faced many shortcomings as follows:

The forms of mobilization was monotonous, traditional, stiff, slow to renovate and not suited to the market requirements.

The attraction of medium- and long-term capital still encountered challenges such as low savings ratio and unstable value of local currency. The people have not been really assured to make their long-term deposits at the bank. The banks lacked effective instruments to mobilize long-term deposits and a secondary market to make easy liquidation by these instruments.

- The banks' investments unveiled some following deficiencies:

The return on investment was not high, the investment structure was irrational. The agricultural sector was craving for capital but offered insufficient funds. In particular, since 1997, the economy has experienced tough times, businesses faced a slump. As a result, the bank credits declined. The market of real estate was flat. There was surplus of products. The state-run firms represented 60% of the total outstanding loans while their production has not yet showed upward tendency. The proportion of loss making state firms has been increasing: 8%; 16%; 25% and 35% in 1993; 1994; 1995 and 1996 respectively. Many non-state firms went bust due to poor management. From

85 to 90% of the working capital in some businesses came from banks credits. The overdue debts made up over 10% of the outstanding loans.

Many joint stock commercial banks had small equity capital. This limited their reputation and financial position and their capability of payment.

The banks' management revealed many mistakes in examining the solvency of borrowers. As a result, these easy lending could threaten the safety of the banking system once the borrowers suffer losses in doing business and go bankrupt.

#### SOME SOLUTIONS TO SECURE THE NETWORK OF COMMERCIAL BANKS

To secure the commercial banks' operations is to well manage assets and liabilities, mobilize more money with low interest rate, utilize capital effectively, hedge risks, raise financial position and ensure payment capability. As such, there need be solutions uniform both in macro-level management and mechanism for business performance to make the network safest. The major solutions include:

1. To perfect the system of policies and regulations to secure a legal framework for the system of commercial banks.

Based on the Laws on Banking and on Credit Institutions, the Government and the State Bank should soon promulgate sublaws to concretize these laws into policies and regulations to shelter commercial banks' activities. The Government should soon perfect policies on guarantee deposits, loans, compulsory reserves, co-financing, collateralization, procedures for lending, regulations on inspection and supervision of funds compensating for risks, information network, risk hedging...

2. To consolidate and

restructure the system of commercial banks:

The system of joint stock commercial banks has made great efforts to develop. However, it currently reveals many vulnerable points because banks' chartered capital is small, their competitiveness poor, staff unstable, management weak and supervision is nominal... These lead to ineffective performance. Their mobilized capital is still low, mainly from the population, non-cash payment activities are not expanded, service quality is not high and overdue debts are increasing.

As a result, the system of commercial banks should be restructured towards the establishment of large commercial banks which have capital potentials, reputations in local and foreign markets and competitiveness in banking activities. The commercial banks should strengthen the organization and operations of their management board, supervision board and staff. In addition, they should perfect and modernize traditional banking services, adopt and improve modern banking technologies, especially rectify their shortcomings in operations.

3. To renew the credit mechanism in the direction of:

- Re-examining and reforming the lending procedures which are simple, effective and safe. Making conditions favorable for farmers to borrow money, at the same time, securing debt payments when due.

- Regulating the collateralization on the basis of the borrower's trustworthiness, not discriminating individuals and organizations and paying attention to the ability to sell the mortgage rapidly.

- Applying lending methods and requirements in line with international common practice, espe-

cially giving loans for projects, long-term loans, and ruling appropriate extension of time for payment and using forms of bridge and preparation loaning.

- Diversifying forms of loans:

Expanding medium- and long-term loans for investments in renovating equipment and applying technical progress with a view to boosting output.

Applying widely the form of finance leasing, especially for medium and small-sized enterprises so that they can acquire opportunities to innovate their equipment and production lines and remove their obsolete machinery.

Using the form of indirect lending (voucher discount) to help develop activities of the stock market.

- Giving loans to many sectors: The commercial banks should take initiative to seek projects and clients, assign qualified officers to help clients devise business plans and formulate profitable projects with the aim to invest the bank's capital effectively and safely. Focusing credits on feasible projects in the development master plan of each locality and sector. Increasing outstanding loans healthily to contribute to the production and economic growth and meanwhile guaranteeing the capital recovery, providing capital on time for farmers and exporters and making the best use of seasonal purchase and favorable prices on local and foreign markets.

Continuing to rectify and consolidate commercial banks' activities to improve credit services such as clarify overdue debts for proper settlement, liquidating mortgage soon, especially collateral real estates associated with land use rights of bankrupt firms, compensating for bad debts resulting from natural

calamity or shortcomings of old policies.

4. To intensify the leading role of state commercial banks

The state-owned commercial banks have to operate fairly according to the market mechanism and show clearly socialist orientation and their leading position in the system of commercial banks. They are strong instruments of the Government to implement its socio-economic targets. They must neither pursue only profits nor always suckle state ailing companies as in the subsidization period.

The commercial banks must observe the market rules, at the same time orientate their banking services towards the Government's economic priorities. They shall find the way to harmonize their business gains with the implementation of social welfare programs when necessary. To strengthen their leading role, they should have potentiality of equity capital. The Government will grant sufficient chartered capital or increase it when need be. They must focus their operations on attracting funds from international financial institutions and making investments in huge projects which have high return, expanding their branches suitably, renovating banking technologies and improve their staff's skill.

5. To strengthen the State Bank's inspection and supervision

To make the system of commercial banks safe, stable and profitable; protect the benefits of depositors; prevent the economy from financial turmoil caused by the banking system, at the same time settle and penalize on time negative acts leading wastes and losses in capital investments, the State Bank shall keep an eye on banks' operations, regularly inspect and supervise them.

The mode of inspection should be reformed, from distant supervision or on-the-spot inspection. The State Bank's inspectorate shall watch closely commercial banks' activities with the aim to discover and analyze timelily doubtful and bad signals which have bad effects on the safety of system. The inspectors should be given good wages and equipped with modern facilities so that their tasks could be fulfilled successfully.

6. To improve the efficiency of internal supervision

Internal supervision is carried out to self-control, self-prevent and rectify shortcomings on time in banking operations. It not only includes checking the finance, accounting, and assets. It must detect the weak points and mistakes in business performance and make useful suggestions to management method and macro-level policies. The system of supervision must be strong in terms of organization and personnel with scientific and flexible methods. The bank should diversify many forms of supervision to soon find out mistakes and hidden dangers in its finance and accounting.

7. To perfect the foreign exchange system and policies

To secure the value of Vietnamese currency and step by step restrain the dollarized transaction, the Government should build the long-run strategy for settling basic foreign exchange rate, take every possible measure for timely adjustment in each period and more importantly, make the foreign exchange rate suitable for the market supply and demand locally and internationally. This will contribute to the stabilization of prices on the local market and avoid devaluating local currency. In forex trading, the banks should apply diverse forms such as spot, forward and

swap dealing to limit risks in the foreign exchange transaction. The banking authorities should study and draw precious lessons from the regional financial meltdowns to prevent social unrest sparked by the banking system's mistakes.

8. To modernize the local banking technologies

The banking system must build state-of-the-art facilities to integrate into the world banking activities.

The commercial banks should widely provide abundant services such as: international credit and payment, collateralization, brokerage and investment, leasing credit, forex trading, co-financing, forming syndicate loans and other services (consultancy, money transfer from overseas Vietnamese, payment, savings...)

The banking technology is implemented via modern network of computers. The banking authorities should soon study feasible projects to innovate their technologies and use application softwares in the system of internal, international and interbank payment, the system managing payment accounts. The process of computerization will be extended to other activities such as risk hedging information, data bank establishment, managing information...

The system of commercial banks and its operations has a crucial effect on the socio-economic development. The well-known economists in the world appreciate highly the role of commercial banks. They said when a country has the system of commercial operating soundly, profitably, and safely, its economy and financial position will be consolidated and firmly grow. Vietnam currently is craving for such a system to industrialize and modernize its economy.