

CREDIT RISK IN HCMC BRANCHES OF FOREIGN BANKS

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In the first half of 1997, there were many encouraging signs in the economy: the growth rate reached 9.1% although it was still low as compared with the growth rate of 9.3% in 1996; the inflation rate was low and the

pared with the planned target of 20% and total deposit increased by 9% as compared with the target of 25%. Although many precautionary measures have been taken, the bad debt showed signs of increase.

In fact, the State Bank has tried to solve this problem by lowering the interest rate, supplying fiduciary loans to state-owned companies, simplifying procedures for getting bank loans and carrying out other measures to increase the total loan supplied. However, to reduce bad debts is no easy task. Many authors have suggested various solutions. In this article, we want to discuss the

0.2% of outstanding loans supplied by these banks in 1996, whereas the banking system suffered 3.7%, state-run banks 3% and joint stock commercial banks 7.3%.

As for bank loan, up to June 30, 1997, total loan supplied by foreign banks increased by 26.5% in comparison with Dec.31, 1997, while the entire banking system made an increase of 7.7% only (loan supplied by state-run banks increased by 7.7% but decreased by 3% in joint stock banks).

The market share of foreign banks in total credit supplied by HCMC-based banks increased from



socio-economic life was stable. The capital for industries, however, is still a worrying problem. In the banking system, the fear of a high degree of credit risk has caused many banks to let their business run down and this situation has led to bribery and damage to the economic development.

In the first half of 1997, total loan increased by only 7% as com-

credit risk in operation of branches of foreign banks in HCMC.

1. Supply of credit from foreign banks

Statistics show that in the first half of 1997, foreign banks in HCMC developed better than other commercial banks and their development was even considered as too hot.

As for bank deposit, up to June 30, 1997, total deposit in foreign banks reached VNĐ4, 671 billion, increasing by 29.6% as compared with last December, while the growth rate of local banks was only 11.02%. Of the total deposit in foreign banks, 8.9% was in VNĐ and 91.1% in foreign exchange. What is remarkable is 66.5% of this deposit came from local companies, that is, they preferred to do business with foreign banks, or in other words, local banks became less reliable in their eyes. It's understandable because bad loans represented only

some 30% in 1996 to 47.7% in the first half of 1997 (compared with a share of 44% controlled by local banks).

These data show that foreign banks have succeeded in expanding their market shares whereas local banks looked like a bull in a china shop.

Moreover, foreign banks not only expanded their market shares, but also supplied better professional services. In the first half of 1997, overdue debt equaled to 20% of total credit supplied by HCMC joint stock commercial banks and state-run commercial banks suffered a percentage of 72% while foreign banks suffered only 1%. In these foreign banks, the proportion of overdue debt to total loan increased by only 0.7% in comparison with the last month of 1996.

To find out causes of this situation, we should examine all aspects of the operation of foreign banks.

a. Supply of medium- and long-term loans

In most companies, sources of self-financed capital are very limited; the Treasury could only provide state-owned companies with some 30% of their starting capital, therefore the demand for capital, especially medium- and long-term capital is great. When there is no capital mar-

ket, all companies have to depend on banks for their much-needed capital, but most local banks failed to satisfy their need, so local companies had to look for help from foreign banks. In the past six months, medium- and long-term loans represented nearly 40% of total loan supplied by foreign banks, while this percentage was 9% in state-run banks, and 3% in joint stock commercial banks.

b. Customer relations

In state-run commercial banks, some 75% of total loan was supplied to state-owned companies. This percentage in foreign banks was 17%. However, foreign banks are supplying more and more credit to state companies: total credit supplied by foreign banks to state companies in the first half of 1997 increased by 100% in comparison with the same period last year, while this increase in state-run banks was 4% only.

c. Guaranteeing commercial L/Cs

Although the State Bank has alarmed banks and succeeded in limiting this practice, but it still was a burden to the banking system. Bad debts became bigger in local banks, which are obliged to supply more loans to their debtors. But foreign banks in this period guaranteed only US\$5 million worth of L/Cs (as compared with US\$365 million guaranteed by state-run banks and 315 million by joint stock commercial banks). Of the amount guaranteed by state-run banks, 11.5% has become bad debt, this percentage in joint stock commercial

banks was 5%, whereas foreign banks met no defaulter.

In principle, if importers fail to repay debt in time, guaranteeing bank should repay it or be obliged to give loans to importers. These loans will certainly become doubtful debts. Total obliged loans supplied by HCMC commercial banks has amounted to US\$90 million (78% of it came from state-run banks).

It's worth noting that although the overdue debt in foreign banks was small, the better part of loans supplied were fiduciary loans. The management of these banks has linked well duties to rights, and preferential treatment to performance.

2. Measures to reduce risk

a. Security couldn't be considered as a guarantee of repayment: Operation of foreign banks shows that although they are ready to supply fiduciary loans, their business involves only a low degree of risk. Contrarily, local banks face a high degree of risk even if they always demand certain guarantees.

Although security can help banks recover loans and interest when loans aren't repaid, it isn't necessary to put stress on security because:

-In supplying credit, the bank doesn't aim at recovering loan, but at helping customers maintain and develop business. Once the bank has to sell the security, everything is over: its customer goes bankrupt, business opportunities are wasted and relationship between bank and

customers comes to an end.

-In Vietnam, selling security is no easy matter and many commercial banks have met with difficulties in selling it.

-If the security is real estate, it requires expenses on maintenance, retrieval and other payments for legal services.

-Dispute over ownership of a security also causes trouble to banks when they want to sell it.

These analyses show that recovering debt by selling security isn't a good measure. In addition, it isn't easy to sell it in current conditions in Vietnam. The following are our suggestions about this problem:

-In supplying either secured or unsecured loans, the bank must observe all regulations on investigation of customers' solvency.

-The bank had better agree to supply fiduciary loans to promising investment projects and customers with good track record. The more information about customers the bank can gather, the less risk it will face.

It's a paradox that a profit-making company has a lot of things to mortgage to banks and in fact, it can get bank loans easily without security, whereas a small company has nothing to give as a security as required by banks. In certain cases, if customers want to outwit the bank, they can give worthless security to banks. Dương Thủy Hiền, Director of Tuyết Thu Ltd. in Nam Hà had mortgaged 47 tittle-deeds for some VNĐ10 billion within two years and after inspection, 45 out of



47 title-deeds were found worthless. In this case, how can banks recover loans?

So what will help banks recover loans isn't the security but customers' business performance.

b. Re-examination of relations between managing ministries, banking system and the Public Property Agency

The Decision 49/CP and Circular 417/CV-NH allowed state companies to get fiduciary loans from banks by presenting their business projects approved by their managing ministries. These documents ruled that after being approved by managing ministries or provincial governments, the business project of the state-owned company is submitted to banks for evaluation. However, these documents didn't define responsibilities of governmental bodies that evaluate and approve the project, so the state-run banks will meet with two following difficulties in supplying credit:

-If the ruling ministries or provincial governments approve the business project but the bank finds it infeasible, theoretically, the bank will refuse to supply loans. But the bank is reluctant to do it for fear of getting into trouble with the ruling ministry or provincial government.

-Even if both the bank and ruling ministry (or provincial government) approve the business project, nobody can ensure that it is risk-free. If the project is against all expectations, who will bear full responsibility for it? The above-mentioned documents didn't make clear this problem. This situation will certainly lead to recrimination between the bank and governmental bodies, and as a result, all investments made by banks become risky.

The policy to allow state-owned companies fiduciary loans is an open policy that can encourage them to expand business, however it will only end in success if the above-mentioned problem is solved.

c. Project evaluation must be carried out scientifically, seriously and minutely

In supplying loan, the fact that foreign banks don't always require security doesn't mean that they supply loan recklessly, but it means that they consider security as a secondary factor. What affects strongly their decision to supply loan are the feasibility and prospects of the project, and they are always careful in evaluating project. That is the way they keep risk degree low when

they are ready to provide fiduciary loans.

Complicated development of the banking business in recent months has made many credit officials tired and confused but it has also warned them against reckless decisions. All credit departments must be reminded regularly that customers' track records and prospects constitute the firmest basis for decisions on supply of loan.

d. Risk assessment must be carried out continuously throughout loaning process.

The loaning process is divided into three phases:

(1) From signing the money lending contract to supplying the loan.

(2) Inspecting during the term of the loan.

(3) Obtaining repayment of the loan.

In each phase, there are different tasks to do and there is a close relation between them, but in nature, the tasks in phase (1) and (3) are clear and of great importance.

In the phase (1), all tasks aim at making decision on or against the supply of loan. In the phase (3), no effort is spared to obtain repayment. However, the tasks in the phase (2) aren't made clear and many bank officials don't know how to inspect ways by which customers use the loan. That is why the tasks in the phase (2) aren't carried out properly. This negligence affects badly the ability to obtain repayment of the loan.

As we know, all businesses will show signs of decline before they go bankrupt. If the bank can't gather information soon, it will fail to recover the loan. If all banks had carried out regular inspections, such criminals as Trần Xuân Hoa or Dương Thủy Hiền couldn't have got away with large sums of bank money.

The bank had better divide the term of a loan into short periods and make risk assessment in each period with a view to taking appropriate measures to ensure repayment of loan if need be.

e. Supplying more medium- and long-term loans

All banks in Vietnam had been aware of this pressing demand but most of them could only see positive effects of medium- and long-term credit on the economic development and failed to realize risk in this service. The supply of medium- and long-term loans isn't risk-free but the best way to reduce banking risk

is to offer terms of loan appropriate to capital turnover of companies.

In the national industrialization, the demand for medium- and long-term capital is great but local banks are reluctant to supply them, therefore many companies had to put short-term loans in medium- and long-term investments (replacement of machines, equipment or production lines for example). That is why the proportion of overdue debt to total loan is on the increase in most local banks and an increasing amount of local companies become regular customers of foreign banks.

So local banks had better supply more medium- and long-term loans, and of course, they have to find out measures to increase their working capital first.

f. Co-financing projects

If one commercial bank is lacking in working capital, it can cooperate with other banks to finance a major investment project thereby sharing risk among them. Moreover, by their cooperation, feasibility and risk degree of the project will be estimated more exactly.

Many foreign banks usually take this measure to finance major business projects in Vietnam. For example, in September 1997, a group of foreign banks (Citibank N.A, First Commercial Bank and some others) agreed to co-finance US\$30 million to the export plan of the Vietnam Coal Corporation.

As for Vietnam's banking system, there must be regulations on the cooperation between local banks in co-financing investment projects because this cooperation will lead to a lot of problems.

g. Credit of low risk degree

At present, many local banks are ready to give bank advance or guarantee although these services involve a high degree of risk (especially the bank guarantee given to importation of consumer goods under deferred-payment terms). They had better pay attention to forms of credit of low risk degree (discounting bill of exchange and promissory notes, financing hire-purchase agreements, etc.).

In addition, improving bank inspection and sense of responsibility of bank officials is also a useful measure.

(This is a paper given at the workshop "Credit Risk and Measures to Reduce It" held on Sep. 30. 1997 in HCMC)