

On Handling Overdue Debts in Commercial Banks

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Overdue debt is a worrying problem to commercial banks and prevents them from making their financial situation healthier and integrating into the world market successfully. In this article, we want to suggest some measures to deal with this problem by developing debt management companies.

1. Causes of overdue debt

Loan capital plays an important role in operations of companies. Generally, companies in the service sector are more depend on this source of finance than those in the manufacturing one.

Overdue debts could be divided into the following classes:

- Secured debts: Assets as security given to banks by borrowers allow banks to take back their money when borrowers fail to repay debts.

- Fiduciary debts: Banks can take back their money if the company borrower is still in business and its financial situation is not too serious.

- Bad debts: Debts owed by companies with poor financial situation that tends to become defaulters are likely never to be paid. In many commercial banks, these debts are sometime left unsolved or written off for three years or more, and they are really burdens to them.

The Table 1 shows that:

The outstanding loan increased over years, which reflected steady growth of the credit supply.

Proportion of overdue debt to the outstanding loan was stable and showed signs of decline. However, it still represented a very large sum of money. That is why it is still a threat to commercial banks. This proportion is high in comparison with the limit accepted by regional banks (under 5%), which represents another obstacle to the integration into the international banking service.

Many causes have led to overdue debts in commercial banks.

a. External causes:

- Company borrowers usually meet with force majeure that prevents them from employing eff-

fective the loan capital and thus suffering huge losses.

- Wide fluctuations in prices of gold, oil, hard currencies or important raw materials increase repayment risks.

b. Internal causes:

- Commercial banks didn't base their decisions on supply of loan on necessary information about customers' solvency and ability to employ the loan effectively. And as a result, these loan become overdue easily. This mistake could be made intentionally by corrupted lending officials who are bribed by customers.

- Many company borrowers have no ability to employ the loan capital efficiently, or convert loans

Table 1: Outstanding loan and overdue debt in 1999-2003

	1999	2000	2001	2002	2003
Category Outstanding loan (VND bil.)	139,180	184,936	225,704	286,614	365,300
Overdue debt as % of outstanding loan	13.2	10.75	8.7	8.15	8.02

Source: State Bank of Vietnam

to other purposes, with the result that their business performance are poor and they become insolvent.

- Some others use the loan capital recklessly and never worry about repayment of debts. These cases are usually found in the public sector.

When facing overdue debts, both banks and borrowers must take actions to deal with them. Borrowers must keep themselves from overdue debts while the bank should have measures to take back the

to prevent this situation from repeating. A company trading in debts and frozen assets of state-owned companies could be established in order to make the financial situation of state-owned companies healthier."

On June 5, 2003, the PM issued the Decision 109/2003/QĐ/TTG to establish the Debts and Frozen Assets Management Company. It got business license No 0106000093 granted by the Hà Nội Service of Planning and

the legal infrastructure ensuring the State control and supervision.

The legal capital of this company is VND2,000 billion granted by the public fund. It is allowed to mobilize other sources of capital (bank loans, issue of bonds, etc.) and open branches or offices in other cities and provinces across the country.

The main task of the company is to buy debts and frozen assets from companies, including the land use rights held by

It's planned that the Company would buy these debts at half the book value and charge a 10% fee of debt collecting. According to this plan, the total cash flow in the years 2004-05 will amount to VND10,561 billion (statistics show that the overdue debt owed by state-owned companies to commercial banks was VND21,218 billion up to Jan. 1, 2000 and this figure rose to VND28,785 billion in early 2004 while the book value of frozen assets was



money or handle debts. At present, many commercial banks have established their own companies to deal with debts. At a higher level and larger scale, the Government or the central bank had better establish a debt management company to solve this problem more properly.

2. Debt management company

The Resolution of the third conference of the VCP Central Executive Committee reads, "the Government should introduce measures to deal with bad debts owed by companies to the public funds and the banking authorities must adopt measures

Investment on Dec. 12, 2003 and its head office situated at 4 Alley 1, Hàng Chuối Street, District Hai Bà Trưng, Hà Nội.

This company represents a new instrument appropriate to the market economy to help companies deal with debts and frozen assets, handle financial problems in order to smooth processes of privatizing, leasing, selling and reorganizing state-owned companies. In these processes, companies have to handle and settle bad debts and frozen assets before and after the revaluation of assets. These operations also help with the development of the stock exchange and other markets, and formation of

companies as security. It could buy them through direct agreements, auctions, or arrangements made by authorities. It could handle debts and frozen assets before state-owned companies are transformed into other kinds of companies; and deal with debts and frozen assets excluded from the revaluation of assets of the companies to be privatized. The Company came into operation in February 2004 and has started a pilot scheme to deal with debts and frozen assets of 20 state-owned companies in a restructuring program including those have run into debt to the tune of VND5 billion or more.

VND3,285 billion). Thus, the Company will need at least VND1,000 billion a year to deal with the total frozen assets at 50% of the value estimated on Jan. 1, 2000.

The Debts and Frozen Assets Management Company is a new and much specialized form of financial institution in Vietnam. It could serve as an instrument for making the financial situation of state-owned companies healthier and facilitating the reorganization of the public sector. We hope that the first company of this kind in Vietnam will produce intended results and support the international integration process of local companies and banks. ■