SUPPLY OF CREDIT IN THE PUBLIC SECTOR

MORTGAGE AND NAKED DEBENTURE

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Recently, the press have reported that commercial banks were very cautious about supplying loans because they had met with difficulty in lending money under mortgage contracts as directed by the central bank. And as a result, capital-deficit state enterprises had to slow down their operation because of a lack of loan capital. To solve this problem, the central bank has petitioned the Government to allow commercial banks to supply fiduciary loans to state enterprises. On May 31,1997, the central bank issued the Official Letter 417 explaining preconditions for supplying fiduciary loans to state enterprises. According to this letter, loans supplied will be determined by company's track record, instead of its equity capital.

Will this be a solution to companies with difficulties? In fact, a good track record doesn't mean that the company will keep on making success. Thus, if state-owned commercial banks are allowed to supply unsecured loans to state enterprises, what will ensure that these loans won't become bad debts? And we must remember that all state commercial bank's capital is from taxpayers. However, if all borrowers have to mortgage property in order to get loan capital, the independence and sense of responsibility of state commercial banks will be limited.

As we know, the supply of credit is the transfer of the right to use a sum of money from the bank to its customers, but in fact, it involves the creditor-debtor mutual confidence. It's the relation that determines the nature of credit services.

Thus, it's unreasonable to demand all borrowers to mortgage property before getting loans, however, we had better not go to the other extreme by allowing all state enterprises to get bank loans without any security.

Credit risk is the chance of loss caused by debtors' default. All businesses, including state-owned ones, can meet with different risks, so credit suppliers must carry out risk analyses and evaluation of borrowers' credit responsibility before deciding on the supply of credit.

In fact, the history of credit service showed that there have been many ways to demand a borrower to give security to a lender in order to support the intention to repay debt. Through credit rating, the lender will decide how much he can loan in return for security he received.

In order to minimize the risk, the credit supplier has to establish close relations with many organizations with a view to gathering information needed for credit rating. Based on these ratings, the credit supplier carries out financial and economic analyses; evaluates borrowers' financial strength, track record, feasibility of the plan to employ loan capital and their future prospects; and then, gives marks to each borrower according to fixed standards.

The credit rating is the method which has been used by lending institutions in the world, especially in developed countries, to classify existing and potential customers. This method has helped them reduce credit risk and bad debts. In countries with well-developed stock markets, capital letters (A, B, C) standing for the credit responsibility of businesses are indispensable for evaluating and deciding on making investments, whereas in Vietnam this practice is still strange to the public and bank managers, that is why the credit quality is poor and the percentage of bad or doubtful loans is high.

The credit supplier usually offers a specified credit policy to each degree of credit rating. One of main features of the credit pilicy is the demand for borrowers to give security. To customers with the highest creditworthiness, the credit supplier can require only a naked debenture. Some people mistakenly think that issuing a debenture, the borrower has given nothing as a security to make sure that he will repay the loan. But in fact, the borrower has given honor, prestige or goodwill to the credit supplier as a security. This kind of intangible assets is of great importance to all companies and none of them want to lose it if they want to be successful in the business world.

For customers with lower creditworthiness, the credit supplier can demand some security which is valuable and saleable. However, in lending money under a mortgage contract, the lender can demand different forms of obligations:

- Equitable mortgage: under this contract the borrower gives the title-deeds of the property (but not the legal ownership of the property) to the lender. The borrower has use of the property.

- Legal mortgage: under this contract the borrower gives both the property and its title-deeds to the lender. The borrower has no right to use the property.

- Assignment: this is the surest mortgage contract that implies transfer of title-deeds, of legal ownership, and of the right to transfer ownership at a later date to the lender if the borrower fails to repay the debt when due. This contract is made with customers with poor track records or the lowest credit ratings.

Thus, regardless of customers' creditworthiness, the lender can carry on supplying loans, and the supply of credit can't be blocked or risky as what happened in Vietnam today. The problem is: What assets can state-owned enterprises give as securities to commercial banks?

As for state-owned enterprises, one of the most urgent problems for them is to legalize the ownership of existing assets so they can mortgage these assets to banks. This legalization not only helps state-owned enterprises make mortgage contracts, but also enables banks to sell the mortgaged property, if the debt isn't repaid when due, in order to obtain repayment of the loan. It's unreasonable to think that the transfer of title and ownership of property from state enterprises to state banks is meaningless because both enterprises and banks are under the state ownership. We must admit that each state enterprise is a legal entity and is has to have assets of its own to give as securities for debts (according to the Civil Code). This problem must be made clear in order to define exactly the responsibility for assets allocated by the Government to the state enterprise.

As for state commercial banks, they can supply short-term fiduciary loans to state enterprises according to their working capital as done before. However, state enterprises that want to secure these loans must make agreements with the bank in which the state enterprise commits to opening accounts at one state bank only and keeping a required balance in the accounts; and supplying all information as required by the bank in order to help the bank keep a close eye on the financial strength of the enterprise. This solution, in fact, means a return to the old mechanism, but it's worth noting that not all old mechanisms are bad and wrong.

The novelty in this approach is that the old mechanism isn't restored by the legislation, but by an agreement about rights and obligations between two legal entities. The state enterprise that wants to secure loans must put itself under the supervision of the lender. On the other hand the lending institution will have to suffer losses if it fails to supervise its debtors. It's necessary to prevent the government interventions in the banking business because these interventions could provide excuses for "intentional violation of regulations' or "lack of sense of responsibility".

To supply medium- and long-term loans to state enterprises, there must be more positive solutions. It's high time the Government had to make a plan to dissolve profitless state enterprises one after another; or to equitize enterprises that the Government didn't need to keep totally under the public ownership with a view to concentrating the government investment on projects of larger scale, or on more important enterprises. Business owners had better find out appropriate ways to increase the working capital, besides depending on banks for long-term loans. Financiers always appreciate the ability to plough back of companies by adjusting the structure of assets and employing amortization funds and retained profits.

An appropriate plan to mobilize all possible sources of finances for an investment project can attract money from the outside of the company, such as: credits from financial leasing companies, credits offered by suppliers of equipment, advances made by customers, sales of bonds, and medium- and long-term loans from co-financing commercial banks.

It's necessary to encourage state commercial banks to apply the mechanism for co-financing a project with a view to sharing out risk among commercial banks. Moreover, by doing so, a lot of mistakes could be avoidable when many banks cooperate with one another in evaluating investment projects ■