



# DEFECTS AND DIFFICULTIES IN CREDIT QUALITY CONTROL

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**E**fficiency of the credit supply service is one of foremost criteria of survival and development of banking business. High efficiency of this service will provide a basis for further developments of a bank, otherwise low efficiency will bring a bank to a period of stagnant growth.

This argument suggests that the task of credit quality control is always an urgent demand, a matter of life and death to a commercial bank, to the banking system and the whole economy as well.

A survey of operation of HCMC-based commercial banks reveals that many urgent problems need to be studied and analyzed carefully and objectively in order to

find out ways to deal with defects and difficulties.

Main defects in the operation of HCMC-based commercial banks are as follows:

- Low efficiency in credit supply service shows itself in the percentage of overdue debts (that is, the risk of bad debts is high). It represents 6.26% of total debit balance by the end of 1996. In 1996, although the State Bank has concentrated its efforts to deal with this problem (by issuing many directives and proposing various measures), 40% of these overdue debts were considered as bad debts (they are one year, or more, overdue).

- Many commercial banks has supplied commercial loans - mainly to importers who bought goods under deferred payment term-beyond their ability to control and attract deposits, therefore this service has sown the seeds of risk of bad debts for commercial banks in the future.

- Some banks, especially joint stock banks, at their first stages of development have been slow to deal with violations of credit control regulations. They also lacked reliable sources of information, so their return on investment became low. By analyzing these facts, we could find out causes of the above-mentioned defects:

## 1. External causes

- A lot of changes in government policies (on foreign trade, on land ownership, etc.) has made the economic environment unstable, produced strong effects on business strategy of companies and credit policy of each bank. Up to now, commercial banks have to keep on

dealing with consequences of these changes.

- Legal infrastructure for banking business was imperfect and defective: the implementation of a regulation or decision was directed differently by many related governmental bodies (for example, guidelines on the Interdepartmental Circular 01 concerning mortgage made to banks). Power of governmental bodies wasn't strong enough to implement tasks relating to banking business. The government control over companies wasn't strict: many companies were allowed to operate in too many fields beyond their ability and working capital with the result that



they had to borrow too much from banks and this situation led to a lot of risks for banks.

## 2. Internal causes

- In each commercial bank, internal control over managers wasn't strict. The management of commercial banks hasn't paid enough attention to the task of realizing the process of loaning, or this task was carried out inefficiently and carelessly, that is, many mistakes have been made.

- Commercial banks lacked information about financial strength, risks involved and ability of applicants for credit. That is why banks couldn't control loans supplied, and a lot of their debtors failed to repay debts when due because they ran their business inefficiently. Generally, many bank officials lack necessary ability and skills to control credit extended, some of them even showed signs of corruption.

- As for the State Bank, the task of supervising and handling violations was carried out irregularly and leniently, therefore the State Bank failed to help commercial banks develop correctly. Banking business is very sensitive to changes in socio-economic development, but many necessary regulations (such as regulations on capital redemption, contingency reserve, mortgage, punishment of violation of banking laws, etc.) aren't made or adjusted in time.

These facts show that the State Bank, and its branches, haven't played well their role in supervising and inspecting commercial banks.

## 3. Measures to overcome defects in banking business

- First of all, commercial banks have to reorganize the process of loaning and establish a reasonable mechanism for making decision on supplying loans with a view to forcing decision-makers to bear fuller responsibility for their decision. This mechanism must facilitate the delegation of rights to make decision on loaning to all executives according to the financial strength of the bank. It's necessary to make clear that the credit board of each commercial bank isn't an advisory body but this board is responsible for making decision on, or against, each loan supplied. The internal control must be intensified in order to ensure that the process of loaning is observed properly. The task of credit investigation must be enhanced with a view to keeping credit risk degree well under

control, and standards of applicant for credit must be set up. Training courses of all levels must be supplied to executives responsible for granting credit.

- As for the State Bank, it's necessary to amend and correct all rules and regulations promulgated in the past in order to make them real law documents instead of being mere guidelines on business operation. The State Bank had better enhance the control over commercial banks, find out measures to overcome defects and correct mistakes made by commercial banks, cooperate with related governmental bodies to reorganize the credit supply service and bank guarantee service offered to importation of goods under deferred payment term. The struggle against corruption in banking business must be intensified in order to regain prestige for the banking system. The system of commercial banks, especially joint stock banks, needed to be reorganized in order to select and consolidate them with a view to building big commercial banks with healthy financial strength, high prestige and modern facilities to meet demands of the socio-economic development in the coming years.

## 4. Suggestions

In 1997, the banking system still faces many difficulties on its way to development. The consistency of macroeconomic policies is very necessary to create favorable conditions for banking operations.

The following are our suggestions concerning this matter:

- The leadership of the nation had better estimate more exactly the contribution of the banking system in our economic development in recent years. Defects in this business must be studied from both external and internal aspects in order to build a correct opinion about activity of the banking system.

- The Government had better put banking activity under the rule of law: all corruptible banking officials need to be punished by law, however, regarding credit risks, governmental bodies had better take measures to help banks recover bad debts. All business disputes must be settled by economic laws and civil code. One of the best ways to deal with this matter is to promulgate the Banking Act which will be the highest rule controlling banking activity and at the same time, protecting legal interests of banks.

- The Government must take measures to control all companies (to force all companies to do business according to licences granted to them, to audit their accounts annually, etc.) in order to ensure healthy economic activity in the market mechanism.

- It's necessary to make policies encouraging the development of the banking system in order to help them compete successfully with foreign banks in the future and consolidate its leading role in the economy.

