

On Sep 30, 1997, a workshop on credit risk was held in HCMC. In the current situation, credit risk is of commercial banks and the State Bank's concern and worry, because overdue debts including bad debts tend to increase although the banks are trying to curb them. Some reasons are attributed to commercial banks' poor management as follows:

- Breaking law and ordinance on banking due to giving to an unit loans more than its self-financed capital, the title-deeds are not legal...
- Breaking the principle and process of offering credit: unsafe credit concentration, not monitoring loans, giving favorable

the collaterals, making policies on loaning, setting up credit council, improving co-financing...

The above-mentioned reasons on the whole result from commercial banks' micro-level management, so the measures presented to hedge credit risk are only within the range of micro-level management as said in the State Bank's report: "the main reason is to lack management systems to control the quality of loaning".

In the current situation, what are major reasons? If the proposed measures are completely taken, to what extent credit risk is reduced?

Regarding quantity, credit risk is calculated by

In 1996 the overdue debts from state-run and joint stock banks amounted to some VND1,069 billion or 4.72% of the total out-



## CREDIT RISK AND SOME MEASURES TO REDUCE IT IN THE CURRENT SITUATION

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treatment to the boards of directors.

- Some reasons from other management: lacking consistence in credit policy, the growth of credits is out of the bank's control, weak supply of information, lacking cooperation to gain information, slow renovation of technology...

- Some reasons from macro-level management: disintegrated legal framework, volatile business environment, poor financial position of enterprises...

To reduce credit risk, some measures were put forward to overcome these reasons such as: observing credit principle strictly, evaluating clients' solvency, paying attention to

a ratio of the overdue debts to the total outstanding loans and the overdue debts are valued by money. In HCMC, according to the State Bank, the overdue debts from 1993 until now are as follows:

In 1993, the overdue debts totalled VND160 billion, of which 95 billion or 59% was owed by the state-run sector.

In 1994 these figures were VND990 billion, 643 billion or 64.9% respectively.

In 1995 the overdue debts reached VND1,000 billion, of which 688 billion came from state-owned banks while the loans of state-run sector represented 70%.





standing loans of which 669 billion came from state-run banks while foreign banks' overdue debts made up 0.1% of the total outstanding loans.

In the first six months of 1997, the overdue debts totalled VND4,905 billion or 20% of the total outstanding loans, of which 3,523 billion came from state-run banks and loans offered to state-owned sector accounted for 74.4%.

Consequently, the state-run banks always have a too large amount of overdue debts and the state sector topped the list of overdue debts.

According to *Diễn Đàn Doanh Nghiệp* (Business Forum Weekly) No 38, from Sep 19 to 25, 1997, the VND multi-billion overdue debts that the banks tried to recover are in fixed assets and on the same issue, the State Bank's branch in HCMC revealed three-fourths of properties mortgaged into banks are houses and land, this collateralization was carried out in banks because most of fixed assets of state-owned enterprises are factories and buildings. According to the State Bank's report in July 1996, regarding clients, overdue debts from loss making businesses accounted for 64%, while collaterals in fixed assets made up 50% of the overdue debts. As a result, the companies' losses are a principal factor leading to large overdue debts, of which the state sector represented the highest percentage and the banks cannot yet retrieve their money via collaterals. It is a main risk the banks are faced with.

In the above-mentioned circumstance, if the banks apply the credit process and proposed measures properly and adequately, they still cannot avoid external risks. The co-financing in this situation can only share losses to each bank, but the total losses of the



banking system remain unchanged. The fact that local banks' overdue debts accounted for 20% of the total outstanding loans while the foreign banks' figure is 0.1% and they are not permitted to accept collaterals in fixed assets indirectly specified the ongoing credit risk field. If the measures to hedge credit risk suggested in the workshop are properly taken, they are able to reduce internal risks in banks and prevent managerial mistakes of borrowers and deception as well. These measures are right in any country and any period. However, at present the strongest effect is the legal infrastructure to deal with collaterals, if this problem cannot be solved, three-fourths of secured loans will turn into bad debts, it is the biggest credit risk. In this case, the reduction of credit risk by internal tools is not effective.

The second important problem is the state-owned enterprises' poor finance presented in some reports. This is not stressed in suggested measures to hedge risks while the state sector plays a leading role in regulating the market. If the banks apply safe fi-

nanacial indicators properly to secure loans then there are not eligible borrowers, so to give fiduciary loans is risky when the current leverage is about five times. If the banks depend on feasible projects to give loans to businesses then their poor finance may cause risks at any time and their projects cannot be implemented. At present, there are 6,000 operational state-owned enterprises, most of them have borrowed money from banks and according to the Ministry of Finance, 20% of these businesses are earning profits, 40% operating perfunctorily and 40% making losses. In addition the Decree 59/CP ruled: "enterprises have limited liability for their operations within their capital including that granted by the State", so the leading economic sector is bearing high risks that the banks encounter. In the second case, micro-level managerial measures produce no good results. The state economy and the banks operate in compliance with the same legal framework and special regulations. If we remove underground economic activities affecting business and production and indirectly causing credit risk

but not being controlled by the macro-level management, the only factor influencing current business and production is the legal framework and regulations of relevant bodies. The noteworthy problems are the settlement of collaterals and state-run enterprises' capital, these problems are under the macro-level management and beyond the banks' authority.

Thirty percent of current overdue debts were arrears before the issue of the ordinance on banking, the increase in overdue debts is mostly out of the banks' authority.

The emergency solution to reduce most of credit risks is to pump extra capital into state-run enterprises, firstly transferring legal ownership of assets to them, at the same time conducting independent audits so that the banks can understand their financial position, initially completing the settlement of collaterals to repay debts to the banks.

The business are going on, the banks are giving loans, once the two above-mentioned problems have not yet been solved completely, the bankers still do acrobatics and try to keep balance between profits and risks.