REGIONAL INTEGRATION AND COMPETITION IN BANKING SERVICE IN THE COMING YEARS

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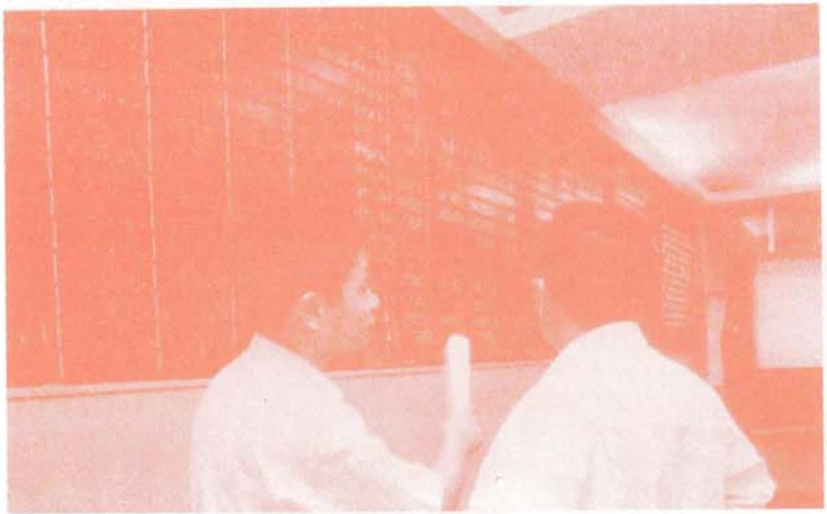

I. Studying groups of banks in Vietnam, we could outline comparative advantages controlled by local banks and challenges posed by cooperation, competition and regional integration in the coming years.

1. State-run commercial banks and banks for political purposes

a. Advantages:

+ Big capital granted by the state (some VND6,000 billion, equaling US$425 million, and 170 million of which is held by the Bank for Agriculture and Rural Development).

+ Wide networks of branches reaching the remotest districts and a big army of officials who know their districts like the back of their hand.

+ Good relationship with local governments of all levels and good knowledge of local traditions and history.

+ Large market shares: some 70% of bank deposits and loans.

b. Disadvantages:

+ Failure to bear comparison with foreign banks: Total legal capital of state-run commercial banks only equals that of branches of foreign banks and joint venture banks in Vietnam and is much smaller than the regional average (from US$2 to 3 billion). In addition, the better part of capital of state-run commercial banks is held in unproductive accounts.

+ Poor skills: Practical and managerial skills of bank officials are very poor in comparison with their counterparts in regional countries. The banking machinery is ineffective and could only supply traditional services (bank deposit and loan).

+ Poor business performance: Most state-run commercial banks have high overdue debt, assets of poor quality and backward facilities; their operation is limited to the domestic market.

2. Joint stock banks:

a. Advantages: These privately-run banks are more active and flexible than state-run ones, so they are more suitable to the market mechanism.

b. Disadvantages:

+ Small scale: The total capital of these banks only amounts to US$160 million, equaling a small bank in the region.

+ Lack of experience and managerial skills.

+ Poor organization: Some joint stock banks are manipulated by certain members of the board of directors.

+ Poor performance: Most of weaknesses of joint stock banks originate from loopholes in the legal framework and state control. Joint stock banks also face the same problems (overdue debt, managerial skills, facilities, etc.) as state-run ones do but they are at a more serious level.

3. Foreign and joint venture banks:

a. Advantages: Big working capital, modern facilities, good management and good customers.

b. Disadvantages: Limited network of branches, language barrier and lack of knowledge of local traditions, customs and history (They should depend on local employees or Vietnamese expatriates dealing with these problems).

Some joint venture banks also face these problems but they are slow to solve them.

The following table show the competitiveness of Vietnamese and regional banks.

Table 1: Size and operation of some Asian banking systems

Nation	Bank deposit/GDP		Bank credit/GDP		Credit/Deposit	
	1992	1998	1992	1998	1992	1998
Indonesia	68%	91%	74%	128%	1.22	1.06
South Korea	37%	54%	58%	78%	1.58	1.44
Singapore	83%	105%	61%	85%	0.74	0.89
Thailand	68%	91%	74%	128%	1.08	1.40
China	73%	117%	95%	125%	1.30	1.07
Vietnam	23%	34%	27.6%	33%	1.14	0.98

Source: State Bank of Vietnam

II. After analyzing the situation we could predict main trends of cooperation and competition between banks in the coming years.

1. Competition between local banks: This is the competition between state-run and joint stock banks for local customers. It will work to the advantage of state-run ones and only a few joint stock banks could develop. If no improvement takes place, the market share of joint stock banks will contract.

2. Competition between local and foreign-invested banks: Branches of foreign banks will increase their market shares when they succeed in attracting state corporations and entering key industries in Vietnam. In addition, they will act as main bankers to foreign investors and joint ventures when the foreign investment in Vietnam rises. Local banks are certainly losers.

3. Competition between branches of foreign banks: Banks from America, Europe, Japan, Hong Kong and Singapore seem stronger than banks from other Asian countries. There are many causes of this situation: strengths of parent banks, structure of customers in Vietnam, structure of foreign investors in Vietnam and structure of Vietnam's exports and imports.

4. Competition between branches of foreign banks and joint venture banks: Branches of foreign banks gain an advantage over joint venture banks, only two of the latter can maintain their market shares.

5. Competition between banks in Vietnam and banks in other countries: Multilateral and bilateral agreements signed by Vietnam force it to liberate the trade in services, including financial and banking ones. In the coming years, Vietnam will have to deregulate banking and financial services as required by international agreements. Existing branches of foreign banks will expand their activities and many others will set up their branches in Vietnam. Greater pressure will be brought to bear on local banks to open their branches in foreign markets.

6. Competition between banks and non-banking institutions: Like banks in foreign countries, banks in Vietnam face competition from non-banking institutions where the public usually deposit their money. Some of these institutions have made their appearance in Vietnam, such as post office savings service, immigrant remittance service, credit card service, etc.

III. In such a situation, we want to suggest here some measures to enhance the competitiveness of local banks. Generally, we need a legal infrastructure that is strict, transparent, consistent and suitable to international practices, Vietnam's treaty-related obligations and Vietnamese conditions. This legal infrastructure should encourage fair competition, favor cooperation on a mutual beneficial basis and struggle against monopoly. Both competition and cooperation should be for the good of the economy, sustainable development of the banking system and its customers. The following are suggested measures:

1. A legal infrastructure that is strict, transparent, consistent and suitable to international practices and Vietnamese conditions:

- There should be an anti-trust law to regulate all economic activities. This law must include clauses and provisions dealing with financial and banking services.

- The Government should issue a decree on competition and cooperation in the banking system. The decree will provide guidelines on implementation of certain articles in the Banking Institutions Law, such as Article 16 "On cooperation and competition in the banking system"; Article 15 "On autonomy in business" and Article 11 "On international cooperation in the banking service", and so on. The decree also gives clear definitions of illegal and unfair competition and cooperation. In the above-mentioned Article 16, there is no provision about illegal cooperation, so the decree should either deal with this loophole or suggest amending the Banking Institutions Law.

- The State Bank of Vietnam had better form a Competition and Cooperation Strategy Board consisting experts from related bodies of the SBV and some major commercial banks. This board will also undertake the task of drafting a decree on cooperation and competition in the banking service.

- At present, there are many law documents providing guidelines on the implementation of two banking laws. This bulk of subordinate legislation contains many regulations relating to cooperation and competition. These regulations should be reviewed regularly in order to reduce the responsibility and intervention of the SBV and give more autonomy and responsibility to banking institutions (full attention should be paid to regulations on bank charges, interest rate, rights and duties of banking institutions, etc.). In short, these regulations will create a framework and won't intervene in operation of banks.

2. Current policies:

a. Tax policy and financial management mechanism: Decree 59/CP followed by Decree 27/CP providing the financial and accounting management mechanism applied to state-owned companies set forth regulations on profit distribution in state –owned companies. The similar regulations applied to banking institutions are set by Decree 166/CP. Main points in these regulations are:

- Company income tax: 32% of profit.
- After-tax profit will be used for the following purposes, in order of importance: adding to the legal capital (5%); covering losses in previous years which couldn't be covered by pre-tax profit; paying charge for the use of capital to the general treasury (6% per annum of capital granted by the treasury), paying fines for which the company is responsible.
- Profit after deducting all of above-mentioned payments will be distributed among the following funds: contingency fund (10%); fund for development (50%); redundancy fund (5%); and fund for bonus and benefit (the rest).

In these regulations about the distribution of profit, we could see some irrational aspects:

+ It seems that the state-run company suffers double taxation, because it pay the charge for the use of capital after paying company income tax.

+ If the after-tax profit is just enough to pay the charge for the use of capital, there is nothing left to the company and its laborers. This tax policy fails to combine interests of the state, company and laborers, therefore it couldn't encourage the better use of capital, that is, better business performance.

+ The capital- use charge of 6% a year (in other words, it is the interest on money lent by the state) is rather high in comparison with the economic growth rate. The state-owned bank enjoys only a difference of 2% (as compared with the average lending rate of 8% a year) but it has to pay company income tax, so it's difficult for the bank to cover overheads and make some profit, especially in current conditions where the economy grows slowly.

+ In comparison with the present deposit rate (from 5% to 6% a year) the capital-use charge of 6% is high and prevents state-owned banks from playing their leading role in the banking system as required by the state.

+ Article 87 of the Banking Institutions Law requires that all banking institutions must use part of after-tax profit to set up and maintain various funds according to percentages set by law. Like the case discussed above, the bank couldn't set up and maintain these funds when the after-tax profit is just enough to pay the capital- use charge.

Thus, the government should petition the National Assembly to amend the above-mentioned regulations in order to help banking institutions, and state-owned banks in particular, accumulate capital and enhance their financial strength. Before fixing the capital- use charge at a certain percentage, the banking authorities had better ask for opinions from banking institutions in order to make the future regulation feasible.

b. Restrictions on operation of foreign banks: All restrictions on operation of branches of foreign banks and joint ventures bank should be considered as harmful to the fair competition. Decision 424/1999/QĐ-NHNN5 made on Nov. 30, 1999 by the SBV Governor admits that joint ventures aren't prevented from receiving deposits, either call or fixed ones, in the VND from Vietnamese individuals and organizations that have no credit relation with foreign-invested banks. As for branches of foreign banks, they could lend 25% of capital granted by their parent banks at most to Vietnamese customers. Thus, they couldn't satisfy demand for big loans and establish good relations with important customers, and as a result, they will lose customers to local banks. In addition, they also face many other restrictions on mortgage, transfer of shares, appointment of general-director of the joint venture bank or branch of foreign bank, and organization of shareholders meeting. All of these restrictions prevent them from enjoying a level playing field ensured by laws. These restrictions should be removed as soon as possible to ensure fair competition and prepared local banks for international integration.■