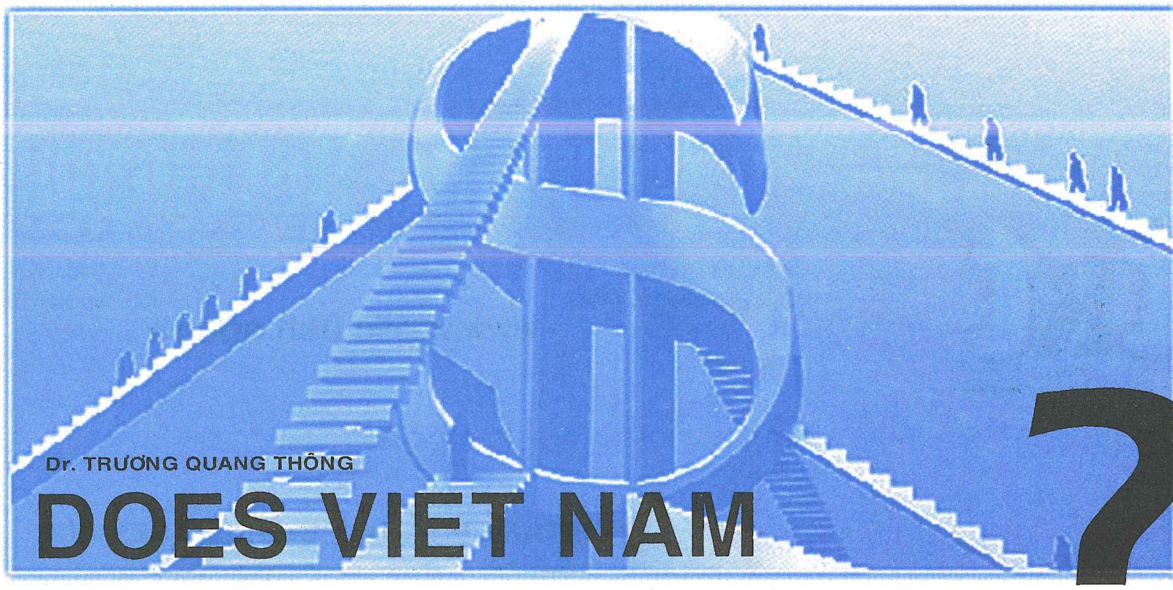

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DOES VIET NAM NEED SMALL BANKS?

Small banks in Vietnam are nearing the deadline for increases in their chartered capital to VND1,000 billion as set by Decree 141/2006/NĐ-CP. The last nine banks in the list can be temporarily called "small banks" (Đệ Nhất, Gia Định, Thái Bình Dương, Mỹ Xuyên, Xăng dầu Petrolimex, Kiên Long, Việt Nam Thương Tín, Đại Tín và Đại Á) and realities show that no joint stock banks in Vietnam want to be classified as "small." In excitement after Vietnam's accession to the WTO, banking authorities wanted commercial banks to beef up their strength in order to enhance their positions in the international integration and competition. Some extreme opinions carried by the press maintained that the WTO membership would put an end to all small banks in Vietnam. Is it certain that all economies, and Vietnam in particular, only need the presence and role of big banks and dismiss the small ones as unnecessary?

1. Small banks in the Vietnamese economy

As reported by the mass media, many experts feared that the nine small banks could hardly increase their capital to VND1,000 billion on Dec. 31, 2008. When the financial crisis spread all over the world and bank stocks fell drastically, offering new shares to existing shareholders and domestic concerns, and looking for new foreign partners were not as easy as in the time two years ago.

Before the Decree 141/2006/NĐ-CP, rural joint stock banks have existed and developed for years beside urban joint stock banks. The urban banks, like their urban counterparts, experienced many ups and downs but as years passed, some of them, such as Kiên Long and Mỹ Xuyên Banks, carried out well their task of serving small concerns, individuals, farming families and rural residents in the Mekong Delta. Due to poor infrastructure and communications, these banks had to limit their activities to certain cities and towns. When changing from rural to urban ones became a trend, along with requirement posed by the Decree 141/2006/NĐ-CP, existence of rural banks seemed to come to an end. Some rural banks seemed to seek for some hard-earned opportunities, and others were trying their best to throw themselves into a whirlwind of activities for survival. Many people wondered if banking authorities anticipated different situations and needs of the economy before introducing such a policy – a common remedy for all concerns with different financial strength – that can influence the structure of the banking system for many years to come.

2. Advantages of small banks

In foreign countries, including the economic powers, small banks still exist beside giant players. In the U.S. for example, there are thousands of small banks and over 50% of them have only US$100 million at most in their capital. They can be called regional or community banks, and most of them are community ones. At present, there is no universally- agreed- upon definition of the community bank, but all experts agree that they all have two features: (1) their size is small; and (2) their activities are limited to the community where their headquarters are located. A third feature that is also taken into consideration is the existence of a majority formed by local shareholders. The first two features usually go side by side: a small market doesn't require a big size; and a small size is appropriate to a limited scope of activities, provided that the bank knows its limits and has no ambition to expand beyond its capacity.

The situation in the U.S. provides us with food for thought. In the whirlwind of financial crisis, these small banks looked safe while other giants were in brink of ruin. Fannie Mae and Fredie Mac scandals broke out, and then the Titan Lehman Brothers collapsed. And more recently, the Citygroup became the center of attention. The once famous saying "too big to fail" has had its new and satirical versions, such as "too big to manage," and "too big to save."

The U.S. is not an exception, studies in many developed and developing show that small banks always have additional roles as substitutes in niches that big banks can not serve better. Big banks usually seem both psychologically and geographically distant from their customers. Customers' services by big banks are mostly based on "hard" financial information, complicated management models run by computers, and centralized decisions. They are accustomed to customer creditworthy rating based on quantitative statistics and financial statements. When selecting customers from hundreds or thousands of application forms, they have too many options and tend to prefer customers of medium and big sizes because these customers are appropriate to their policies and management methods.

We can see that, therefore, customer relations of big banks are usually based on transactions (transactional banking) while activities of smaller ones depend mostly on relations (relationship banking) and advantages arising from long-term interaction with customers. Small loans are usually supplied to local customers, hereby, close and friendly relations come into being, which save small banks from cost of evaluating and analyzing business plans offered by customers. Familiar to local residents and business climate, small banks also realize that they should offer better services because they rely a lot on local savings. Different studies show that, as for small loans, small banks can obtain an average difference in interest rate that is bigger than the ones gained by big banks. This means that lending service by small banks is more profitable than that of the big players. The big banks, in fact, also realize that advantage and they can acquire the smaller ones. After acquisition of small banks, however, practical studies show that efficiency of small loans by small banks tends to decrease, not to mention the fact that the big banks are not much interested in small loans.

These are analyses of management. Regarding the macroeconomic aspect, the small banks, because of their size and geographical limits, don't have as big shares in the systematic risk as the big ones do. Situation of American banks in the past few months demonstrates this argument.

3. Policy implications

What anticipation do the Government and the SBV make for banks that fail to increase their capital to VND1,000 billion on Dec.31, 2008? This is an important and urgent problem in present difficulties. In my opinion, dissolving the weakest banks is not a safe solution when some small banks have made some progress and expanded their activities geographically. Merger could be seen as a better measure but it is no easy task if it is based on decision from the banking authorities. The merger sometimes is not appropriate to macroeconomic targets while the economy in general, and rural areas and informal sector in particular, are badly in need of small loans and other services from small banks. The small bank is an objective existence because it has an undeniable contribution to the economic growth. I think that the policy is still logical and acceptable when it brings about changes appropriate to economic laws. The SBV can work out a more careful plan for increases in the chartered capital of small banks, along with implementation of more appropriate policies and models of management and supervision■

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