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Foreign bank penetration in Vietnam following Vietnam's accession to the WTO: matching expectations with reality

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Abstract

Vietnam continuously liberalizes the financial market as a requirement for its accession to the World Trade Organization in 2007. This paper discusses the foreign investors' expectation and their experience when penetrating into Vietnam's market. The role of the foreign entrants is also assessed. By synthesizing and analyzing relevant research and reports, several important insights are discovered. Firstly, the presence of foreign investors and banks improves market competition, efficiency, and stability. Wholly and partly foreign-owned banks provide the spillover effects in management quality, in the introduction of world standard banking products and services, and in the application of information technology. Secondly, by looking into the foreign owned banks, it is found that the banks' foreign investors are not likely to play an influential role in managing the banks they invested in. The motive of the investors to control the invested companies leads to their decision of holdings withdrawing.

Keywords: Foreign banks, Foreign investors, Vietnamese banks, Firm performance, Vietnam

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1. Introduction

Financial liberalization is widely considered an important strategy for hosting countries to improve their financial system. However, financial liberalization brings both benefits and challenges for a nation in maintaining a prudent financial system (Claessens and Lee, 2003; Barajas *et al.*, 2000; Goldberg, 2007; Deminguc-Kunt and Detragiache, 1998; Levine, 2001). The previous study of Schmukler (2004) shows that financial globalization provides net positive effects in the long run as it can lead to the development of the financial system, however, it come with crises and contagion.

The banking sector openness is the most important stem of the financial system development that attracts widespread interest, not only in developed countries but also in emerging countries (Claessens *et al.*, 2001; Clarke *et al.*, 2003; Detragiache *et al.*, 2008; De Haas, 2014; Gosh, 2016; Claessens, 2017; Horen, 2007). The banking system is the prominent source of financial system funding, and also is the most sensitive and fragile financial sector under the context of financial liberalization. Considering its importance and sensitiveness, further exploring banking liberalization is significantly meaningful to both macro policymakers as well as banking stakeholders (Mian, 2005; Lehner and Schnitzer, 2008; Hasan and Hunter, 1996; De Haas, 2014; Clarke *et al.*, 2003).

According to the literature, the hosting countries benefits from banking efficiency, new technologies, products, management quality as well as increased competition stimulated by foreign entrants. As noted by Claessens and Van Horen (2014), the impact of foreign bank presence on private credit significantly depends on the characteristics of the host country and the banks. Accordingly, foreign banks seem to only have a negative impact on credit in countries characterized as low-income. These contries also limit the degree of market share held by foreign stakeholders, require costly enforcing contracts and limit the credit information.

In countries with low levels of financial development, foreign entrants have significant negative impacts on domestic banks in terms of profits and cost inefficiency aHermes and Lensink, 2004; Hasan and Lozano-Vivas, 1998, Gosh, 2016). Claessens *et al.* (2001) have investigated how net interest margins, overhead, taxes paid, and profitability differ between foreign and domestic banks. They found that foreign banks have higher profits than domestic banks in developing countries, but the opposite is the case for developed countries.

For emerging countries, studying financial and banking market opening is even more important. Specifically, it is increasingly becoming pivotal for a small country with a fragile financial system like Vietnam since it has been experiencing a gradual financial liberalization process. Thus, a small shock in the global market may cause detrimental effects to the local banking market (Batten and Vo, 2009; 2015; 2016; 2019; Vo, 2009; 2015; 2017; Vo and Phan, 2017). As a focal point integrated in the dynamic ASEAN bloc with extensive trade network (Nguyen *et al.*, 2018; Nguyen and Vo 2017; Vo, 2016; Vo *et al.*, 2016), Vietnam has witnessed a great achievements in financial and banking system development. This is the result of the country's experience of a sharp reformation, a prudential banking system adoption and a sensible financial liberalizing pace.

This paper offers a comprehensive highlights in the Vietnamese banking market. Even though various studies provide a framework for analyzing expected costs and benefits of financial liberalization in general, and foreign bank entry in particular, the literature about Vietnam remains scarce (Ferrari and Tran, 2020; Vuong, 2019; Turnell and Vu, 2018; Nguyen, 2016; Steward *et al.*, 2016; Le, 2014; Phan and Daly, 2014; Waal *et al.*, 2009; Kovsted *et al.*, 2003; Oh, 1998). This paper is meaningful since it provides a comprehensive landscape of foreign banking entrants and their roles to Vietnam banking development. Exploring the context of a unique banking history like Vietnam is interesting on its own merit.

First, this study provides a inclusive background on the Vietnam banking market since Vietnam's accession World Trade Organization (WTO). Second, we discuss the roles and the performance of the foreign investors the Vietnamese banking market. The remaining discusses the advantages and disadvantages of foreign bank entry and the expected changes that foreign banks and investors bring to Vietnam's banking system development. The final section provides some concluding remarks and implications.

2. Background of Vietnam's banking market

Vietnam has opened up its banking sector since the early 1990s. The past decades have witnessed a rapid growth in this sector associated with gradual financial liberalization.

2.1 Pre-WTO accession

Since the transformation from the mono-banking system into a dual-banking system in the 1990s, Vietnam's economy has witnessed a transitional renewing accompanied with the financial liberalizion. The State Bank of Vietnam (SBV) plays as the central bank. Meanwhile, four state-owned banks (SOCBs) including Bank for Foreign Trade of Vietnam (VCB), Bank for Investment and Development of Vietnam (BIDV), Vietnam Industrial and Commercial Bank (Viettinbank), and Vietnam Bank for Agriculture and Rural Development (Agribank), are separated and seen as commercial banks. From 1990, foreign banking investors are allowed and motivated to apply for licenses to establish branches or representative offices in Vietnam under Ordinance on Banks, Credit Cooperatives and Finance company (1990). After 15 years of gradual liberalization, in 2006, Vietnam's banking system has shown a remarkable rise in number, which comprises four SOCBs, thirty-seven joint-stock commercial banks (JSBs); thirty-one foreign banks (FBs), and five joint venture banks (JVBs), correspondingly (The Banking with the Poor Network, 2008).

Table 1 illustrates the reformed and gradually liberalized banking system in Vietnam from 1991 to 2006. Vietnam's banking sector has proved wide-ranging achievements regarding the number of banks, institutional type, asset scale, and business scope. Under the liberalization context, the number of foreign bank offices, branches and foreign joint venture banks rose notably during the period of 1995-2006. This happened thanks to the lift of the United States trade embargo and Vietnam's ASEAN membership in 1995, as well as its WTO accession in early 2007.

Table 1. Number of banks in Vietnam in the period of 1991-2006

Banks	1991	1993	1995	1997	1999	2001	2005	2006
SOCBs	4	4	4	5	5	5	5	5
Joint stock banks	4	41	48	51	48	39	37	37
Foreign banks	0	8	18	24	26	26	29	31
Foreign Joint Venture banks	1	3	5	4	4	4	4	5
Total	9	56	74	84	83	74	75	78

Source: Authors' compilation

It was evident that the SOCBs had dominated the banking sector, even though their privileges had been removed, in reality, their specialty remained. Table 2 depicts the market shares in lending and fund mobilization in Vietnam banking market, in which the largest proportion is accounted by SOCBs. However, this tendency tends to be lessened year by year.

Table 2. Vietnam's banking market shares in lending and deposit mobilization by institutional types

Unit: (%)

		1993	1994	1995	1996	2000	2001	2002	2003	2004	2005	2006
SOCBs	Deposit	91	88	80	76	77	80	79	78	75	74	69
	Lending	89	85	75	74	77	79	70.8	65	79	78	76
JSBs	Deposit	6	8	9	10	11	9	10	11	13	17	22
	Lending	7	11	15	14	9	9	10	11	12	15	21
FBs and JVBs	Deposit	2	3	10	13	11	10	10	10	10	8	8
	Lending	3	3	8	10	12	10	9	9	10	10	9

Source: Authors' compilation

Vietnamese authorities are practical about gradual financial liberalization as restrictions on foreign presence and entry have been set prudentially. Since the Vietnam and United States Bilateral Trade Agreement (BTA) was signed in 2000, the wholly-owned US banks are allowed to enter Vietnam following a moderately open progress. The limit for deposits in Vietnamese Dong applied for the US and Europe-based banks had been loosening from 10% in 2000 to 25%, 50%, 250%, and eventually 400% of the branch's capital in 2006 (Turnell and Vu, 2018). Furthermore, to comply with the BTA, the adjustment of the 1998 Law on Credit Institutions in 2004 calls for 100% US owned subsidiary banks to be established by 2010. This eventually was available to other foreign investors under the WTO accession requirements in 2007.

Vietnam's banking market has had significant changes in the context of financial liberalization since the 1990s, after "Doi Moi" renovation. Moderately liberalization progress falicitates Vietnam's success of the prudent and stable financial system in the period of 1990-2006 (Ho and Baxter, 2011; Leung, 2009; Vo and Chu, 2019). In such context, the regulatory framework helps Vietnam's banking sector in grasping opportunities and being well prepared for challenges resulted from global liberalization.

2.2 Post-WTO accession

As an official member of the WTO since early 2007, there has been a considerable rise in the foreign banks' penetration and investments into Vietnamese banking sector. They major forms of penetration are merger and acquisition (M&A), new branches, wholly foreign owned banks, and minority shareholdings. The entering of foreign banking investors proved to show its significant spillover effects, especiallly in operational standards and performance of the Vietnamese banking system.

The Vietnamese banking authorities have continuously made efforts to establish the regulations and countermeasures in accordance with the integration context. Respectively, the Decree 141/2006/ND-CP dated 22 November, 2006 on the roadmap for Vietnamese bank capital improvement was issued to strengthen and foster the competitiveness of Vietnamese banks. It is considered a milestone in enhancing Vietnam banking sector competitiveness (Ho and Baxter, 2011; Turnell and Vu, 2018; Vo, 2018; Vo and Nguyen, 2018; Vu *et al.*, 2018). Vietnam's economy witnesses a rapid growth in bank capital, bank credit and assets expansion, cross-ownership taken among Vietnamese banks. Consequently, the rural banks transformed into urban ones.

Simultaneously, in order to deal with the economic shrinking following the global financial crisis 2007-2008, a 1 billion USD equivalent interest subsidy was launched as one of stimulus packages to facilitate its businesses. Expected to be a strong financial wheel power to aid the Vietnamese businesses in overcoming the recession, however, the stimulus package consequently results in unexpected macroeconomic turbulences. The upshot of policy was conscious since the financial and banking turmoil already occurred, signalling by high inflation rate, interest rate volatilities, nonperforming loans (NPLs) and unfair competition among Vietnamese banks (Nguyen, 2016; Vo, 2018; Vo and Nguyen, 2018; Vu *et al.*, 2018). The NPLs in Vietnam in 2011-2012 were extremely high since several banks NPLs approach 12%. Among joint stock banks, Saigon Commercial Bank (SCB), Vietnam National Bank (NVB), Sacombank (STB), Maritimebank (MSB), PG Bank (PGB), and Tienphong Bank (TPB) suffered the most severe NPLs problems in the period of 2010-2014.

On the other hand, to comply with Decree 141/2006/ND-CP on bank capital requirements, many rural local banks have struggled to transform into urban banks. In such context, Vietnam has witnessed a sharp increase in urban bank numbers that caused more severe economic turbulences and an imprudent banking system, resulting in macroeconomic imbalances in financial resources allocation among industrial sectors and regional areas (Vu *et al.*, 2018).

Table 3 shows the list of transformed banks from 2003 to 2008. Dramatic rise in banking number was not set in line with banking management capability improvement since Vietnamese banks deployed low standards of banking corporate governance, ignored monitoring systems, and slowly renewed accounting framework for their operations, as pointed by several scholars (Vu *et al.*, 2018); Vo and Nguyen, 2018). To confront such situation, Vietnamese authorities not only take strict and close supervision and resolution on weak and illiquid banks but also foster banking system towards global operational standards. The resolution of acquiring and merging insolvency banks are given and taken accordingly.

As a result, the effort to reform and enhance Vietnamese banking system prudence resulted in a decline in bank numbers from 42 to 35 during the period of 2011-2019 (Turnell and Vu, 2018). The restructuring and fostering progress significantly enhanced Vietnamese banking system with a more adaptive scheme towards international liberalization of which the foreign banks are considered a pivotal force facilitating prudential banking operation and banking competition in Vietnam. There were nine poorly performing banks forced to be merged, acquired, or restructured accordingly: Habubank merged with Saigon Hanoi Bank (SHB); Tinnghiabank and Ficombank merged with Saigon Commercial Bank (SCB); three poorly performing banks namely PG Bank, Trust bank renamed as Construction Commercial Bank (CB) and Ocean Bank were acquired by SBV at zero Dong; Westernbank consolidated with PVFC to be newly named PVcombank; self-restructured Tienphong Bank partnered with DOJI; and solely self-restructured Namviet Bank (nowadays known as National Citizen Bank).

3. Foreign bank entrants' expectations and reality in Vietnam's banking industry

Vietnamese economy has witnessed a wave of foreign banks investing in Vietnamese banks prior its WTO accession. During this period, under Vietnamese regulation, foreign investors were allowed to acquire at the ceiling room of 30% of total shares. However, the states of their initially partnered and finally offloaded upshots imply that there have likely been many hints behind.

The foreign banking investing into Vietnam's market could be classified into two main groups. The first one is by on-boarding with the local Vietnamese banks by acquiring company shares. The second method is often one in three common modes, namely foreign subsidiaries branches, and representative offices.

Foreign investors who penetrate by acquiring shares usually expects long-term profitability and efficiency from their investment. In reality, they often face struggles and dissatisfaction. Table 3 lists out the typical deals acquired by foreign banking investors from prior WTO accession to date. Among these cases, the cooperation between the Japanese enterprise named Sumitomo Mitsui Financial Group (SMFG) and the Vietnamese company since 2007, known as Eximbank, is considered typical. In this partnership, the Japanese investor has limited and minor voting rights, which could be seen by the presence of only two permanent members joining Eximbank's Board of Directors of total 10 participants. In execution, Eximbank reconstruction and corporate governance performed poorly. This led to its sharply shrunk share prices that are below the price excecuted by SMBC. As a consequence, it is likely that the strategic partner SMBC (SMFG's subsidary) has been stuck with their investment in Eximbank.

Apart from aiming for control, there was evidence showing that foreign banks entered Vietnam to seek for profitability in the short term. The right-handed column in Table 3 shows that there have been considerably offloaded cases among acquiring foreign investors. From our observation, foreign banking investors were likely to divest their unprofitable deals/businesses while on board with local partners. There had been no official excuses disclosed from both foreign and local partners for completely offloaded cases. The cases of HSBC, OCBC, and ANZ separating from Techcombank, VP bank, and Sacombank, respectively, are considered typical examples of fortunately divesting deals taken. These were considered to be fortunate since thee foreign acquirers sold their shares at expected executing prices.

More importantly, it is unlikely that many foreign banking investors had been satisfied with their domestic partners since they did not play significant roles in the management of the local partner banks. In particular, the local context of fierce competition and overcrowded company presence posed difficulties in doing business, consequently, disencouraging investing.

Furthermore, the state's regulation on the maximum of 30% of stake that forgein investors can hold in a company is considered to cause significant obstracles for these investors (Vo and Nguyen, 2018a; 2018b; Vo and Chu, 2019; Vo *et al.*, 2016; Vo, 2009). This situation is similar to the Chinese banking market since most foreign banking investors there have sold out their investments (Li *et al.*, 2015). The foreign bankers consider acquiring banks in emerging countries as one of their short term strategies.

However, in comparison with other countries in the region, Vietnam's policies for banking industry seem to be fairly open. According to the WTO analysis of market access liberalization, Vietnam was open to liberalization and was leading in terms of the number of opened sectors, joint venture requirements, and limits on foreign-owned shares. Meanwhile, China, Thailand, Malaysia, Indonesia and other countries in the region are categorized as the medium level.

Concurrently, there had been three common modes in Vietnam offered to foreign banks as subsidiaries, branches, and representative offices. Among these, subsidiaries are considered the most favorable since they are treated equally compared to local banks. The number of foreign bank subsidiaries increases from five to nine banks in the period of 2015-2019, correspondingly. Meanwhile, the threshold of branches and representative offices remains steady, which is around 50. Table 4 presents the number of foreign banks according to their classification mode.

Table 3. Foreign investor partnerships in Vietnam's banking sector

No	Foreign bank investors	Vietnam banks	Partnership		Offload (if any)	
			Year	Share acquired (%)	Year	Share sold (%)
1	Standard Chartered PLC	Asia Commercial Joint Stock Bank (ACB)	2005	15	2017	15
2	Australia and New Zealand Banking Group Limited	Sai Gon Thuong Tin Commercial Joint Stock Bank (Sacombank -STB)	2005	10	2012	10
3	Sumitomo Mitsui Financial Group	Vietnam Import-Export Commercial Joint Stock Bank (Eximbank)	2007	15	-	-
4	HSBC Bank Vietnam Limited	Vietnam Technology and Commercial Joint Stock Bank (Techcombank - TCB)	2005	19.41	2017	19.41
5	Deustche Bank	Hanoi Building Commercial Joint Stock Bank Current (*)	2007	10-15	-	-
6	BNP Parisbas	Orient Commercial Joint Stock Bank (OCB)	2007	10-18.7	2017	18.7
7	Societe' Generale	Southeast Asia Commercial Joint Stock Bank (SeABank - SEB)	2008	20	2018	20
8	May Bank	An Binh Joint-stock Commercial Bank (ABB)	2008	15-20	-	-
9	Common Wealth of Australia	Vietnam International Commercial Joint Stock Bank (VIB)	2010	20	-	-
10	Fullerton Financial Holding	Mekong Development Bank	2010	15-20	2015	20
11	Mizuho Corporation Bank	Joint-stock Commercial Bank for Foreign Trade of Vietnam (Vietcombank – VCB)	2012	15	-	-
12	Bank of Tokyo Mitsubishi UFJ	Vietnam Joint Stock Commercial Bank for Industry and Trade (Vietinbank – CTG)	2012	20	-	-
13	Oversea Chinese Banking Corporation Limited (OCBC)	Vietnam Commercial Joint Stock Bank for Private Enterprise (VP Bank –VPB)	2016	15	2013	13
14	IFC, PYN Elite Fund	TienPhong Commercial Joint Stock Bank (Tienphong Bank – TPB)	2016	4.38-4.99	-	-

Note: (*) Merged into Saigon Hanoi Commercial Joint Stock Bank (SHB) (2012)

Source: Authors' compilation

Table 4. Number of foreign banks in the period of 2015-2019 in Vietnam

Foreign bank mode in Vietnam	Explanation	2015	2016	2017	2018	2019
Subsidiaries	A wholly foreign-owned subsidiary which is equally treated as local banks	5	6	8	9	9
Branches	Gradually loosening deposit limits from 2008-2011. Affiliation of foreign home bank	49	51	51	48	49
Representative offices	Being not allowed to take banking businesses but facilitating transactions between host country market and home country bank	51	51	49	49	50

Source: Authors' compilation

Table 6 shows that there has been a tendency of SOCBs and JSBs threshold dominating the local market shares in both lending and depositing, surrounding 90-92% in depositing and 92-95% in lending market, correspondingly. That said, the share of foreign banks remains quite low in both lending and depositing markets. This context of Vietnam is associated with studies by Claessens and Van Horen (2014; 2012). Haselmann (2006) indicates that foreign banks in low-income countries seem to have a little impact on the credit market with low market share. The foreign investors find asymmetric information problems and disadvantages of credit contract compliance. This scenario raises the hints beyond the foreign investor expectation and reality since being on threshold of Vietnamese banking market penetration.

The foreign banks operated in Vietnam under common mode of foreign subsidiaries demonstrate their superior performance in terms of profitability and efficiency.

The research by Hasan and Hunter (1996) and Focarelli and Pozzolo (2000) indicate that seeking profits and efficiency is considered the investors' priority when deciding to enter a foreign market. The scenario in Vietnam clearly show the investor's motive since the foreign banks outperform local banks. The net interest margin (NIM), return on asset (ROA), and return on equity (ROE) are considered the key indicators in measuring banking performance. In terms of NIM, foreign banks are documented to sustain a steady rate of average 3.78%, which is higher in comparison to the local banks.

In particular, the NIMs among Vietnamese local banks differ quite much, ranging from 1.69% (SEAbank) to 5.62% in average (VPbank), in the period of 2010-2018. Foreign countries are deemed to have advantages of low-cost source funding derived from the home country, the information technology, the well-skilled staff and diversified professional services. These are considered the key elements driving foreign banks to lower operating cost, preferable income, and competition. This result is consistent with preliminary studies by Barajas *et al.* (2000), Scheack and Cihak (2010), and Jeon *et al.* (2011), which indicate that foreign banks contribute to lower the interest rate offered by domestic banks, hence, increase competition, efficiency and soundness.

Table 6. Vietnam's banking market shares in both lending and mobilization

Unit: (%)

Types of banks		2014	2015	2016	2017
SOCBs	Deposit	43.3	46.1	49.1	49
	Lending	52.4	53.2	52.9	51.8
JSBs	Deposit	47.9	45.7	42.9	42.4
	Lending	41.5	41.4	40.1	41.3
FBs and JVBs	Deposit	8.8	8.2	7.7	8.6
	Lending	6.1	5.4	7.0	6.9

Source: Compiled from National Committee of Financial supervision (NCFS) and SBV's annual reports

Foreign banks outperformed domestic ones regarding ROA, however, the opposite happens with ROE. The majority of foreign banks' ROE performed at a moderate level, except for HSBC Vietnam. This company were in the ROE-outperforming bank group, accompanied by Vietcombank, PV bank, and Techcombank. It should be mentioned that foreign invested banks have the advantages of inexpensive-cost fund, prudential banking management, diversified products and services, and modern banking technology. All these incentives contribute to cutting foreign banks expenses. However, it is evident that foreign banks have recognizably high operating costs relating staff, property, and other costs compared to domestic banks.

Foreign banks are tightly restricted on branch outlets, transaction points and mostly locate in costly places in the centers of big cities, mainly in Hanoi and Ho Chi Minh City. They are also disencouraged in nationwide network expansion and banking infrastructure charged by domestic offering banks and suppliers. These elements are considered the key factors explaining why foreign banks do not outperform domestic ones in ROE.

However, it is interesting to note that the foreign banks' ROA, a financial ratio that indicates how profitable a company is in relation to its total assets, were significantly higher than local bank's, ranging from 0.81-2.59% on average in the period of 2010-2018. It should be added that, the Vietnamese banks were struggling in meeting capital adequacy requirements under the Basel II standards. Therefore, Vietnamese local banks' high financial leverage was driving their outperformed ROE while leading to underperformed ROA, which is a prominent sign of low bank efficiency and managerial capability.

Foreign banks stood out in facilitating non-interest services since they aquired averagely higher non-interest income proportion and total operating income than domestic banks. There may be possible explanation that foreign banks are advantaged in providing advanced services of foreign exchanges, global market dealings, derivatives, guarranties, trust. Meanwhile, domestics banks still concentrate on conventional banking services of interest-oriented products, namely deposits and credits.

Studies about foreign banks finding business opportunities in transitional countries (Claessens *et al.*, 2001, Berger *et al.*, 2005; Barth *et al.*, 2001) indicates that restriction on entry is associated with higher NIM and overhead costs. Accordingly, following the global advantage theory, foreign banks may take advantage of arbitrages while operating multinationally since they outperform domestic banks in terms of language, culture and other barriers. Claessens *et al.* (2001) also pointed out that one of the targets of the foreign bank is to continue doing business with their existed long-lasting clients from the mother country. This is observed in Vietnam. The foreign invested banks in Vietnam had close networks with their mother company's long-lasting clients, specifically their foreign direct investment clients from countries that Vietnam has well developed economic and trade relations.

However, it is not surprising that the foreign banks are struggling with penetrating potential domestic clients due to barriers of language and culture differences. Since Vietnamese people are accustomed to using banking services offered by conventional local banks, particularly SOBs such as Vietcombank, Vietinbank or long-lasting joint-stock banks including Techcombank, VIB, PVBank. Moreover, asymmetric information is considered a considerable obstacle in preventing foreign banks to approach potential clients. Nevertheless, there had been a tendency that foreign banks try to approach local clients, especially the high-income class. The case of Shinhan Bank Vietnam acquiring ANZ retail services is an example. This context of expanding host country client networks and fostering competitive reaction of local lenders is associated with preliminary studies by Grosse and Goldberg (1991), De Haas and Naaborg (2006), Claeys and Hainz (2014), Bruno and Hauswald (2014), Clarke *et al.* (2003), and Althammer and Haselmann (2011). Accordingly, domestic banks have more soft available information about their borrowers compared to foreign banks. However, foreign banks have a superior screening technology that allows them to obtain more information about their borrowers' investment projects.

4. Advantages and disadvantages of foreign investor and banks entry and their roles in Vietnam – from host country's perspectives

The presence of foreign invested banks results in bettering risk management capacities, advanced information technologies and global standard of banking products and services (Batten and Vo, 2015; Steward *et al.*, 2016; Turnell and Vu, 2018; Phan and Daly, 2014; Vo and Nguyen 2018). In Vietnam, in the recent decades, foreign invested banks have became an important contributor in improving the Vietnamese banking sector. The preliminary studies by Batten and Vo (2015), Ho and Baxter (2011), Kovsted *et al.* (2003), Vo and Nguyen (2018a), Vo (2018), Turnell and Vu (2018), Waal *et al.* (2009) consider foreign banks penetration and investment in Vietnam as a tremendous attribute that generated more intensive competition, efficiency, and stability for all banks.

There was a significant reinforcement in banking corporate governance, transaction transparency, and regulatory compliance with Basel II standards practices, and banking efficiency (Batten and Vo, 2018; Vo and Nguyen, 2018; Vo, 2018). From prior to the WTO accession to date, it is documented that foreign banks investing in Vietnamese local banks almost come from developed or regional countries. These nations applied the advanced standards of prudential banking operations. Correspondingly, this movement fosters the local banks to improve their operation capacities. As a result, there has been a remarkable advancement in Vietnamese prudential banking operation towards international standard practices. This is in line with the highlights by Kouretas and Tsoumas (2016) showing that foreign bank presence exerts a positive impact on the efficiency of business regulation. Respectively, Vietnamese banks are more consciously aware of their operational prudence and soundness after experiencing financial turbulences of non-performing loans, cross-shareholding, and unfair competition. These turbulences resulted mainly from their poor lending practices, weakness in corporate governance under pressure of banking openness, and fierce competition and threats from foreign competitors (Nguyen, 2020). Nevertheless, Vietnamese banks proactively restructured themselves to enhance their competitiveness (Le, 2014). This context is in line with the results of previous study of Claessens *et al.* (2001), Cardinas *et al.* (2004), and Hermes and Lensink (2004), indicating that competition is associated with foreign banks presence.

Under competition pressure derived from foreign banks presence, Vietnamese banking system has been continuously fostered and enhanced towards Basel Accords practices. It is seen that the Vietnamese system has gotten better year by year. Prior studies also suggested that the presence of foreign invested banks fosters the efficiency of domestic banks (Claessens *et al.*, 2001; 2017; Goldberg, 2007; De Haas and Van Lelyveld, 2006; Lehner and Schnizer, 2008; Havrylchyk and Jurzyk, 2011; Mody and Peria, 2004). Notably, in recent years, there has been a remarkable upward trend in Vietnamese banks' performance, specifically in efficiency. Their ROE and ROA indicators show an increasing tendency through the years. These contexts are associated with explanation by Claessens *et al.* (2001), which posited that foreign bank entry motivated local banks to lower their costs by applying modern technologies. As a response to modern technology application, more prudential banking operation emerges with lower risks and lower cost.

The Vietnamese banking sector experienced a stabilizing progress after tumbling due to issues of cross-ownership and poor lending practices. After overcoming the stabilizing progress, the sector overally had reached more prudential operation practices towards international standards. Specifically, there established a revolution in new banking technologies, more regulatory compliance, skilled managers and global-minded staff, which are considered the driving forces of Vietnamese banking stability and soundness in recent years.

Assessing this reality, the studies of Barajas *et al.* (2000), Degryse *et al.* (2012) proposed that the foreign banks entry causes a overall pressure in the banking sector, which aided to the founding of its soundness and stability. However, other preliminary studies by De Haas and

Van Lelyveld (2006) and De Haas and Van Horen (2012) indicated that foreign invested banks are considered either stabilizing or destabilizing force depending on their lending. Because the foreign banks have dominated the lending markets, there would be very likely for capital withdrawing to happen when the market shows any signals of financial crisis or instability. Foreign invested banks in Vietnam indicate an outstanding performance with very low non-performing loans, more diversed products and services. This explains the positive spillover effects in domestic banks prudence and soundness in recent years.

Contrary to the mentioned positive effects brought by the foreign investment, the fact that the foreign invested banks cherry-picking their clients was concerning (Berger *et al.*, 2009; Clarke *et al.*, 2003). This is notable in the banking business in Vietnam. In practice, foreign invested banks tend to seek the best and most creditworthy clients, taking advantage of their inexpensive funding. On the other hand, Vietnamese domestic banks, particularly private joint stock banks, eventually lower the bars of screening and monitoring process to confront such a situation. Attracting potential borrowers became prioritized. Consequently, the foreign companies' practice of cherry-picking their clients has been an issue causing Vietnamese banking system turbulences in years.

In sum, foreign invested banks are recognized as the driving force of Vietnam's rapid banking development in recent years. The penetration of the foreign investors brought in fiercer competition, higher efficiency and more regulatory compliance towards international practices. However, because the foreign banks took a cherry-picking approach in lending, some problems have occured. A potential risk of capital withdrawal is also pointed out as one of the critical disadvantages.

5. Conclusion

Vietnam's banking sector has witnessed a rapid development since the liberalization progress started in the early 1990s. According to the WTO accession requirements, foreign banks are allowed to operate under modes of either subsidiaries, branches or representative offices in Vietnam (Ho and Baxter, 2011; Turnell and Vu, 2018; Vo and Nguyen 2018). We found that foreign banks penetrated the market quite well as their market share followed an upward trend. However, foreign invested banks are strugged to expand their market share, unlike the local joint stock banks, given that there were a declining trend in market shares of state-owned banks.

We explore the roles of foreign invested banks in Vietnam with reference to their expectations and reality. Accordingly, our paper demonstrates the outperformance of some foreign subsidiaries in terms of profitability and efficiency, and points out that others struggle in acquiring shares from the local banks. We found that due to the limitation of shareholding, it is unlikely that foreign investors play an influential role or an infuential voice in the invested local banks. Several foreign investors/foreign partners eventually withdrew or divested their holdings because of dissatisfaction.

The positive effect from the spillover brought by foreign invested banks through penetration into Vietnam concerning management quality, introduction of world standard banking products and services, and the application of information technology were stated. However, the negative effects of cherry-picking practice and short-term investment strategies are worth considering.

In forthcomings, Vietnamese banks are still in the progress of continuous restructuring and reforming towards achieving international practices. This target is essential and requires more resources of capital, technologies, corporate governance capabilities, information disclosure enhancement, stakeholder engagement, and qualified human resources. In addition, Vietnamese local banks should be more proactive in finding new strategic partners to meet the capital requirements in compliant to the Basel II application and to confront the pressure from fierce competition.

Moreover, the advantages of Vietnamese macroeconomic factors and the prospects of multilateral agreements are remarkable driving forces to attract more foreign investments, especially in the banking industry.

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