

Reality of Vietnam's Commercial Bank Performance and Soundness

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ABSTRACT

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This paper employs CAMELS rating system to evaluate the performance and soundness of Vietnam's commercial banks. Based on the analysis of data from financial statements of the banks in the years 2005/2008–2013, the research results show that the total assets and equity capital of Vietnam's commercial banks have increased, but their efficiency is not yet high and tends to gradually decrease. The expense-to-revenue ratio was higher than 80% while the return on assets (ROA) ratio remained around 1% and had a tendency to sharply fall to 0.77% and 0.56% in 2012 and 2013 respectively. The return on equity (ROE) ratio, in addition, fell steadily in 2012 (7.42%) and 2013 (5.84%). The findings also indicate that profitability of state-owned commercial banks is higher than that of private joint-stock ones. Additionally, risk degree was high because of a high bad debt (around 4%) and low liquidity (around 90% of loan-to-deposit ratio). In addition to its analysis, the research offers several recommendations that aim at improving banking efficiency and mitigating risk as for Vietnam's commercial banks.

1. Introduction

It is obvious that Vietnam has been in a move toward greater internal integration into the world's economy, yet its financial and banking system has just been at a start: Financial market is still at a preliminary stage of development, and banking system is in the reconstructing, improving in the diversification of ownership forms as well as new products. International economic integration has not only created opportunities for development but also posed big challenges to the financial and banking system in Vietnam. Global economic health that has not yet recovered produces a bad effect on Vietnam's economy and especially negatively impacts on the system.

Based on the data collected from SBV, there are totally 47 commercial banks operating in Vietnam until 2014, among which five are state-owned commercial banks (Agribank, BIDV, Vietcombank, Vietinbank, and MHB), five are 100% foreign-owned banks (ANZ, HSBC, Standard Chartered, Shinhan, and Hong Leong), four are interbanks (VID Public bank, Indovina, VinaSiam, and VRB) along the total of 33 private joint-stock commercial banks and 52 foreign branches. Total assets of all commercial banks are USD180.5 billion, in which state-own, foreign-owned, and private joint-stock commercial banks hold USD68.3 billion, USD5.5 billion, and USD106.7 billion respectively. Total assets held by commercial banks in Vietnam are nearly twice as much as Vietnam's GDP. However, the poorer asset quality (reflected by bad debt indicator) and lower liquidity signal inefficient operations and high degree of risk that Vietnam's commercial banks may have been facing. Through the recently reported statements from SBV, the ratio of bad debt to total loans is over 4% in the first six months of 2014. Meanwhile, liquidity index is revealed by the loan-to-deposit ratio (LTD). This ratio, particularly, of the whole system of commercial banks is 91.9% in 2013 and over 89% until June, 2014.

Through the aforementioned reality, the paper aims to demonstrate the current soundness of Vietnam's commercial banks. Basically, the authors use the CAMELS framework to estimate the soundness of individual commercial banks as well as calculate the average soundness of whole sector of commercial banks in the surveyed sample. Established by IMF's experts, this research framework is globally employed by many researchers as a sound basis for estimating the soundness of commercial banking systems.

2. Review on CAMELS indicators and selection of applied indicators to assess the soundness of Vietnam's commercial banks

Primarily, the indicators of financial and banking system's health are considered by the accumulation of data on the soundness of individual financial institutions. As the most commonly applied framework for assessing the health of individual institutions, CAMELS involves six categories affecting their health: (1) capital adequacy (C); (2) asset quality (A); (3) management soundness (M); (4) earnings (E); (5) liquidity (L); and (6) sensitivity to market risk (S).

Major indicators of CAMELS system are presented below according to Evans et al. (2000):

Capital adequacy indicator – C: The most commonly used indicator in this respect is the ratio of capital to risk-adjusted assets. The decreasing trend in this ratio may signify an increase in risk exposure.

Asset quality indicators – A: The indicators of asset quality include those at the level of lending institutions (commercial banks) and indicators at the level of borrowing institutions (such as enterprises, households, etc.).

Indicators at the level of lending institutions consist of sectoral credit concentration, foreign currency-denominated credit, and non-performing loans. An increasing trend in the ratio of non-performing loans to total loans indicates a deterioration in the quality of credit portfolios, and consequently, in cash flows, net income, and solvency of commercial banks.

Indicators at the level of borrowing institutions: the quality of a financial institution's loan portfolios directly depends on the health and profitability of the borrowers.

Management soundness indicators – M: management soundness is a key to financial institution's performance, including such indicators used as its representation as expense ratio, earnings per employee, and expansion in the number of financial institutions (such as branches, agencies, etc.).

Earnings and profitability indicators – E: Unprofitability is a reason for the risk insolvency of financial institutions; therefore it is important to follow the profitability. Such indicators of commercial banks' profitability can be used as return on assets (ROA) and return on equity (ROE).

Liquidity indicators – L: Used indicators of financial institutions' liquidity consist of: (1) loan-to-deposit ratios; and (2) maturity structure of assets and loans.

Sensitivity of market risk indicators – S: The most relevant components of market risk, in general, are interest rate and foreign exchange risk, which tend to highly impact financial institutions' assets and loans.

From the review of the indicators of CAMELS framework above and considering the ability to collect data in Vietnam at present, the authors propose several indicators for assessing the soundness of a financial institution/commercial bank, namely: capital adequacy – C [considered as the capital adequacy ratio (CAR)]; asset quality – A (regarded as banks' non-performing loan ratio); management – M (including the ratio of expenses to revenue; earnings – E (based on banks' profitability, consisting of ROA and ROE); liquidity – L [the current ratio of current assets to current liabilities; if current liabilities exceed current assets (the current ratio is less than 1), banks may have problems with their liquidity, and no liquidity risk reveals if current assets exceed current liabilities (the current ratio equals or is larger than 1)]; and sensitivity to market risk – S (used to measure interest rate risk calculated by the ratio of interest rate sensitive asset to interest rate sensitive liabilities).

3. Methodology and data sources

The research mostly applied qualitative analysis by its calculations of CAMELS indicators to compare changes in indicators of the surveyed commercial banks as well as measure the industry average of each indicator employed as banks' thresholds compared to common ones. Data sources were mainly collected from financial statements having published by both Vietnam's state-owned and private joint-stock commercial banks in the 2005/2008–2013 period. General data include an aggregation of those from 38 domestic commercial banks in the period of 2005–2013; whereas the ones applied to measure CAMELS indicators were collected from 29 domestic banks in 2008–2013.

4. Analysis of the performance and soundness of Vietnam's commercial banks

4.1. Bank's performance analysis

According to SBV, there are currently 39 domestic joint-stock commercial banks (Vietnam's commercial banks), whose total assets and equity increased over years as illustrated in Table 1.

Table 1

Total assets, equity, and growth speed of Vietnam's commercial banks in the years 2005–2013

Unit: VND billion, %

Year	All Vietnam's commercial banks				State-owned commercial banks				Private joint-stock commercial banks			
	Total assets	Speed	Equity	Speed	Total assets	Speed	Equity	Speed	Total assets	Speed	Equity	Speed
2005	500,914		31,091		386,256		20,797		114,659		10,294	
2006	709,563	42%	50,291	62%	482,528	25%	25,346	22%	227,035	98%	24,945	142%
2007	1,128,510	59%	96,342	92%	595,564	23%	36,902	46%	532,946	135%	59,440	138%
2008	1,355,474	20%	124,616	29%	697,493	17%	40,868	11%	657,980	23%	83,748	41%
2009	1,927,077	42%	159,449	28%	835,811	20%	48,087	18%	1,091,266	66%	111,362	33%
2010	2,815,624	46%	222,210	39%	1,092,687	31%	66,273	38%	1,722,937	58%	155,937	40%
2011	3,417,119	21%	267,104	20%	1,280,180	17%	84,707	28%	2,136,939	24%	182,397	17%
2012	3,524,248	3%	297,162	11%	1,440,770	13%	105,112	24%	2,083,478	-3%	192,050	5%
2013	3,827,338	9%	323,490	9%	1,593,749	11%	128,501	22%	2,233,589	7%	194,989	2%
Average speed	28.9%		34.0%		19.4%		25.6%		44.9%		44.4%	

Source: DIV 2014 – A summary of Vietnam's commercial banks

It can be stated that total assets and equity of Vietnam's commercial bank system have strongly increased during 2005–2013 with an average of 29% and 34% per year respectively. Especially in 2011 when financial crisis ended, total assets kept sharply increasing from 20% to 59% and of equity increased from 20% to 92% per year. However, their rate of increase had a tendency to decrease in 2012–2013.

Strong development in the size of private commercial banks (with average increase of 44% per year) is a contribution to significant increase in total assets and equity of Vietnam's commercial banks. The reason for the increase in banks' assets and equity is demands for legal capital increase (compliant with Decree 141/2006/ND-CP) and

charter capital increase by VND3,000 billion as defined by SBV’s regulations in end-2011. The year 2012 was recorded with many difficulties faced by Vietnam’s commercial banks in their business performance, so their total assets and equity tended to fall down.

In accordance with statistical data from SBV, until the end of 2013 total assets of the commercial bank system kept rising and reached the highest level of VND5, 755.87 billion and this figure in charter capital is VND422.98 billion. Implementation of bank merger in conjunction with the project of credit institution restructuring in 2011–2015 causes a gradual decrease in the number of commercial banks. Figure 1 and 2 describing total assets and charter and/or equity capital of Vietnam’s commercial banks show that state-owned and private joint-stock commercial banks reveal outstanding assets and equity; next come foreign banks and interbanks, but their total assets and charter capital tend to increase over years. Besides, the number of total assets and equity capital of financial institutions are at the modest level.

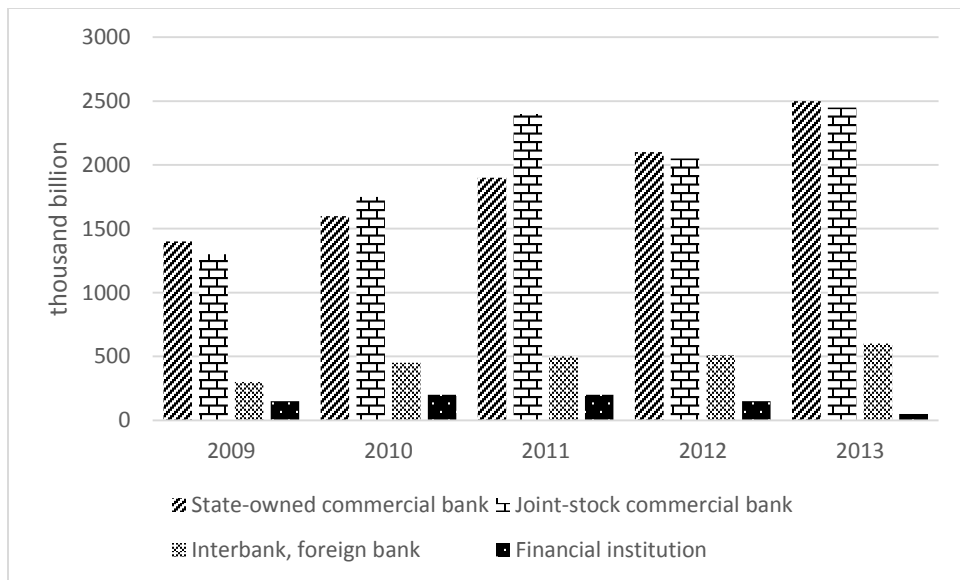


Fig. 1. Total assets of banking system in the 2009–2013 period

Source: Annual reports from SBV

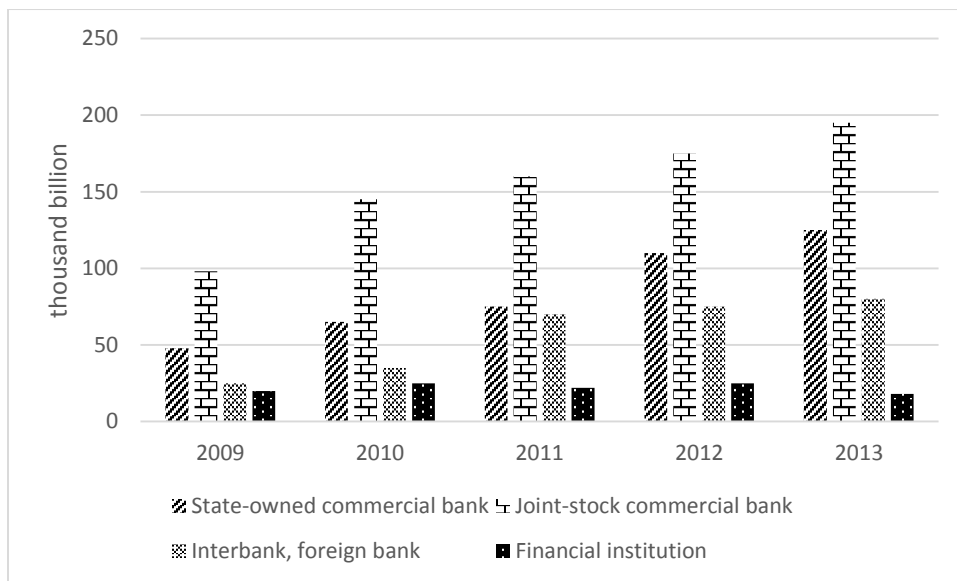


Fig. 2. Charter capital of the banking system in the 2009–2013 period

Source: Annual reports from SBV

Capital mobilization: This activity conducted by Vietnam’s commercial banks in the years 2008–2013 is reflected through Table 2, which shows that the growth rate of banks’ deposit in this period was quite high, at an average of 20.33% per year; this figure in private joint-stock commercial banks was 29.23% per year, which was twice as high as the growth rate of state-owned commercial banks (at 13.97% per year). The proportion of deposit of private joint-stock commercial banks increased from 36% per year in 2008 to 51% per year in 2013, in contrast to the proportion of deposit of state-owned commercial banks that decreased from 64% to 49% per year in 2008 and 2013 respectively. Although deposit interest rate falls down, the growth rate of deposit still highly increases due to the fact that saving is considered a safe and attractive channel for financial investment in the current economic context. With an advantage of increasing customer deposit, these banks can make use of relatively stable and cheap capital sources for their lending activities as well as other business operations.

Table 2

Capital mobilization of banks in the 2008–2013 period

(Unit: VND billion; %)

Order	Types of banks	2008		2009		2010		2011		2012		2013		Average increase speed
		Absolute number	Proportion	Absolute number	Proportion	Absolute number	Proportion	Absolute number	Proportion	Absolute number	Proportion	Absolute number	Proportion	
1	State-owned commercial banks	995,300	64%	1,202,948	56%	1,480,419	49%	1,647,581	47%	1,800,364	50%	1,913,560	49%	13.97%
2	Private joint-stock commercial banks	553,152	36%	934,809	44%	1,513,925	51%	1,858,904	53%	1,824,884	50%	1,993,803	51%	29.23%
Total		1,548,452	100%	2,137,757	100%	2,994,344	100%	3,506,485	100%	3,625,248	100%	3,907,363	100%	20.33%

Source: DIV 2014 – Data summary from financial statements of surveyed commercial banks

Lending service: During 2005–2013, the lending service with improvement in annual credit balance was still a priority of domestic commercial banks. Total balance of state-owned commercial banks accounted for 70%–80% of total annual balance of the whole credit system. Both state-owned and private joint-stock commercial banks have showed continually increasing balance over years. The difference in lending operations among the banks became gradually smaller. Credit growth at a relatively high level in early-2010 as required by SBV led to the fact that credit growth of the whole commercial banking system was always at two-digit level. The customer credit growth speed was as high as 47–63 per cent at some time, reaching an average of 28% per year for the whole period. In state-owned commercial banks, the customer credit growth and interbank credit growth reached an average of 20.8% and 13.7% per year respectively. These figures in private joint-stock commercial banks were 41.5% and 40.1% per year. Since 2011, due to SBV’s control, the customer credit growth speed has gradually decreased, at 12%-14% per year while the figures for the interbank were smaller than zero (Table 3).

Table 3

Loan balance of Vietnam's commercial banks in the 2005–2013 period

(Unit: VND billion, %)

Year	All Vietnam's commercial banks											
	State-owned commercial banks								Private joint-stock commercial banks			
	Customer loans	Speed	Interbank loans	Speed	Customer loans	Speed	Interbank loans	Speed	Customer loans	Speed	Interbank loans	Speed
2005	293,395		98,258		225,394		76,224		68,001		22,034	
2006	368,936	26%	158,958	62%	253,571	13%	104,738	37%	115,364	70%	54,220	146%
2007	599,963	63%	218,504	37%	338,748	34%	85,050	-19%	261,215	126%	133,453	146%
2008	707,569	18%	229,691	5%	400,037	18%	85,564	1%	307,532	18%	144,127	8%
2009	1,043,353	47%	376,370	64%	519,536	30%	118,854	39%	523,817	70%	257,517	79%
2010	1,423,365	36%	574,892	53%	673,815	30%	202,502	70%	749,551	43%	372,391	45%
2011	1,668,866	17%	753,366	31%	805,237	20%	239,591	18%	863,629	15%	513,775	38%
2012	1,897,438	14%	561,853	-25%	923,768	15%	180,675	-25%	973,670	13%	381,178	-26%
2013	2,119,409	12%	539,715	-4%	1,025,742	11%	212,473	18%	1,093,667	12%	327,242	-14%
Average speed	28%		23,7%		20,8%		13,7%		41,5%		40,1%	

Source: DIV 2014 – Data summary from domestic commercial banks

The group of state-owned commercial banks is rated higher on its stability of credit growth with well-maintained average of around 20.8% per year. Huge capital, network spreading across provinces, and the large number of customers including extremely large-scale state economic groups are contributory factors in such stability. Meanwhile, the credit growth of private joint-stock commercial banks is at high levels, but it is lacking in stability. The period 2005–2013 also marked certain excitement in interbank loans. Those banks which could not boost their customer loans during this period had part of their capital transferred to this kind of loans.

High risk born by high credit growth when the world has yet to completely escape from the economic crisis has more or less impacted on Vietnam's economy, which results in the slow growth rate of the country in those past years. Also, this affects the performance as well as operational quality of the commercial banks. The following

section carries out an assessment of the soundness of Vietnam’s commercial banks based on CAMELS indicators.

4.2. Reality of the soundness of Vietnam’s commercial banks based on CAMELS indicators

4.2.1. Capital adequacy indicators

Capital adequacy ratios perform core capital used to support banks’ business operations. The more risk banks take, the more core capital is required in order to improve their performance, thereby making up for the potential loss related to higher risk degree. Two indicators, the ratio of equity to total assets and CAR are discussed in the next part. Particularly, Table 3 below indicates changes in the equity-to-asset ratio of surveyed commercial banks in the years 2008–2013.

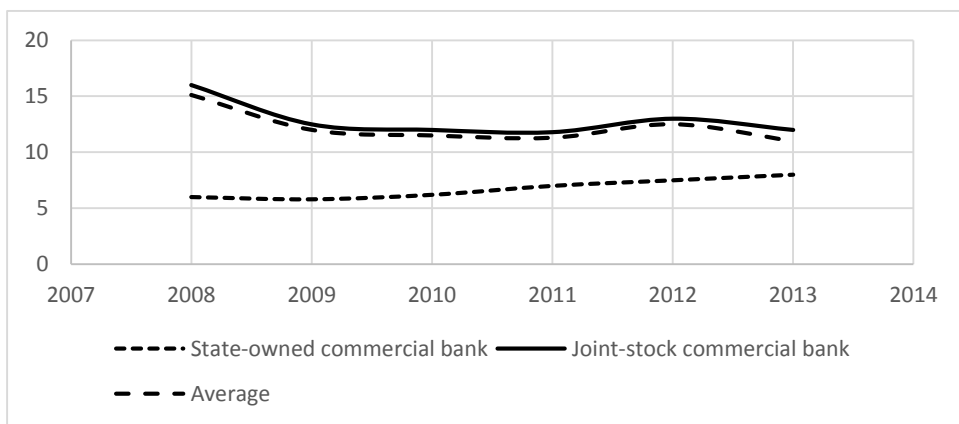


Fig. 3. Equity-to-asset ratio of banks in 2008–2013

Source: Data summary from surveyed commercial banks

The ratio of equity to total assets of Vietnam’s commercial banks had a tendency to decrease gradually (from over 15% in 2008 to over 11% in 2013). Despite its rich capital source, state-owned commercial banks had lower equity-to-asset ratio than private joint-stock ones (8% compared to 11.4% in 2013), which shows that state-owned commercial banks employed financial leverage in their business competition with private counterparts. Yet, decreasing equity-to-asset ratio is a signal for risk increase and bad financial soundness (debt capital is many times as much as core capital).

One of the important indicators to measure banks' capital adequacy is CAR. The current average of CAR of the whole commercial banking system is more than 12%, and CARs of 17 commercial banks in the sample are performed in Table 4, the results of which indicate that the majority of banks have achieved the indicators of ensuring CAR according to a set rate of 9% prescribed by the State Bank. Yet, CAR has seemingly decreased since 2007. The major reason for the decreasing ratio is rapid increase in banks' assets compared to the core capital growth rate. Since 2007 the scale of total assets has reached such a great expansion that the core capital growth rate could not possibly keep pace with, which reduced CAR of some banks especially in 2010 and 2011. This is an advance warning of risk degree of total assets for banks to make an appropriate adjustment in accordance with their profits.

Table 4

CAR of several banks in 2008–2013

Order	Bank	2008	2009	2010	2011	2012	2013
1	CTG	12.02%	8.06%	8.02%	10.57%	10.33%	12.31%
2	BID	8.94%	9.53%	9.30%	10.00%	9.04%	10.02%
3	VCB	8.90%	8.11%	9.00%	11.14%	14.83%	12.41%
4	TCB	13.99%	9.60%	13.10%	11.43%	12.60%	N/A
5	ACB	13.00%	11.00%	10.06%	9.30%	13.52%	13.05%
6	MBB	12.35%	12.00%	12.90%	9.59%	11.00%	N/A
7	EIB	45.89%	26.87%	17.79%	12.94%	16.38%	13.68%
8	STB	12.16%	11.41%	9.97%	11.66%	9.53%	10.22%
9	MSB	14.55%	15.00%	11.00%	12.41%	11.31%	N/A
10	SEA	N/A	N/A	13.72%	13.29%	15.50%	N/A
11	EAB	11.30%	10.64%	10.84%	10.01%	10.85%	N/A
12	VIB	N/A	9.59%	9.48%	11.74%	10.36%	N/A
13	OJB	21.64%	28.71%	20.59%	N/A	N/A	N/A
14	NVB	55.50%	45.11%	54.92%	N/A	N/A	15.79%
15	VCA	26.90%	12.90%	20.60%	16.70%	22.60%	N/A

Order	Bank	2008	2009	2010	2011	2012	2013
16	KLB	18.04%	18.04%	18.04%	20.29%	19.21%	16.77%
17	NAB	34.04%	43.51%	37.29%	55.87%	N/A	N/A
	Average	20.61%	17.51%	16.86%	15.13%	13.36%	13.03%

Source: DIV 2014 – Data summary from financial statements of commercial banks

4.2.2. Asset quality indicators

The ratio of non-performing loans to total loans is used as an indicator to measure asset quality of commercial banks. According to Circular 02/2013/TT-NHNN, these non-performing loans are considered as credit amounts that must be classified as those in Debt Groups 3, 4, and 5. The higher the non-performing loans, the lower the asset quality. Fig. 4 below shows non-performing loans among 29 commercial banks in 2008–2013.

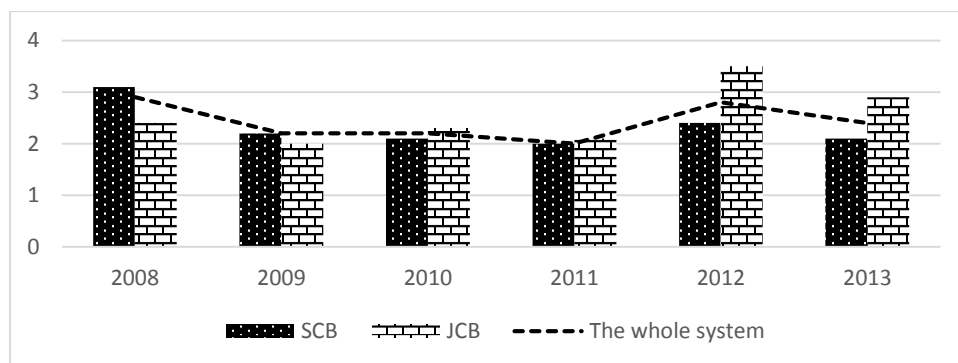


Fig. 4. The ratio of non-performing loans to total loans in 2008–2013

Source: Data summary from surveyed banks

The non-performing loan rates of banks have increased from 2%–3% in the years 2008–2013; particularly in 2012 the figure was 3.57%. However, SBV’s statement concerning the first six months of 2014 shows that the average rates of non-performing loans of the whole commercial banking system rose over 4%. The majority of banks that have the high bad debt rate belong to the group of low competitiveness and small assets and equity capital. In addition, a drop in the quality of loans causes the banks to enhance loan loss provisions.

In accordance with regulations by the State Bank, most of credit amounts must ensure specific provisions with the rate of 0% (Group 1), 5% (Group 2), 20% (Group 5), 50%

(Group 4), and 100% (Group 5). Also, general provisions must be ensured with the rate of 0.75% for the groups 1–4. Thus, a rise in the ratio of loan loss provisions to total loans is closely related to a drop in the credit quality. The risk-provision-to-asset ratio of Vietnam's commercial banks in the 2008–2013 period is presented in Figure 5 below.

The ratio of loan loss provisions to total loans tended to increase in the years 2008–2012 and starts to slightly fall down until 2013. The 2008 economic crisis made a negative impact on business conditions, which resulted in poor customers' payment capacity. Also, higher non-performing loans in commercial banks accelerated risk provisions.

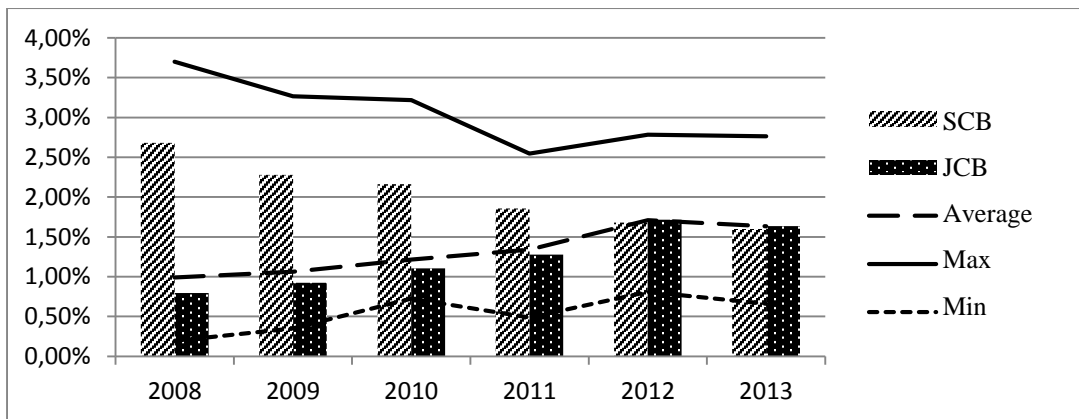


Fig. 5. Ratios of loan loss provisions to total loans in the 2008–2013 period

Source: Data summary from surveyed banks

4.2.3. Management indicators

Banking management aims at creating a system of unified activities in which the labor processes of both staff in different departments and board members are coordinated and connected with each other, thereby reaching the purpose in every specific period on the basis of reducing human costs. Management soundness of commercial banks can be measured by the ratio of expenses to total revenue, which demonstrates banks' ability to manage their expenses. The higher the ratio, the poorer the management soundness will be, which leads to lower profits. The average expense-to-revenue ratios of 29 commercial banks in the sample are given in Table 5.

Table 5

Average expense-to-revenue ratios of Vietnam's commercial banks during 2008–2013

	2008	2009	2010	2011	2012	2013
SCB	76.80%	74.06%	74.84%	76.14%	75.11%	71.44%
JCB	81.89%	71.81%	76.35%	82.06%	84.98%	84.39%
Average	81.52%	71.97%	76.24%	81.62%	84.27%	83.36%
Max	97.90%	92.13%	92.60%	96.34%	97.14%	95.49%
Min	46.23%	58.95%	63.45%	62.46%	66.68%	62.27%

Source: Calculations from banks' financial statements

The average expense-to-revenue ratios of commercial banks are approximately higher than 80% in the years 2008–2013; particularly, the ratios of private commercial banks reach higher value than those of state-owned banks (these figures of some private banks are over 95%–97%). This might exert a strong impact on banks' performance as well as reduce their competitiveness in the context of economic integration. The ratios of private joint-stock commercial banks, to a specific extent, tend to rise. Cost structure clarified in banks' financial statements shows that salary and staff expenses account for 50% of total operating expenses, making a contrast to the global trend in which an increase in operating expenses should be subject to that in customer service expenses because of customers' demands for abundant goods along better service quality. High expenses and low improvement in customer services have driven Vietnam's commercial banks to poorer competitiveness. It is evidenced by the fact that foreign banks step by step raise their stocks on banking and financial market in Vietnam (see Fig. 1 for increase in total assets).

4.2.4. Earnings and profitability indicators

Earnings and profitability indicators reflect a bank's performance and assess its business efficiency and level of development. ROA and ROE are two major ratios served as indicators of current financial sector profitability.

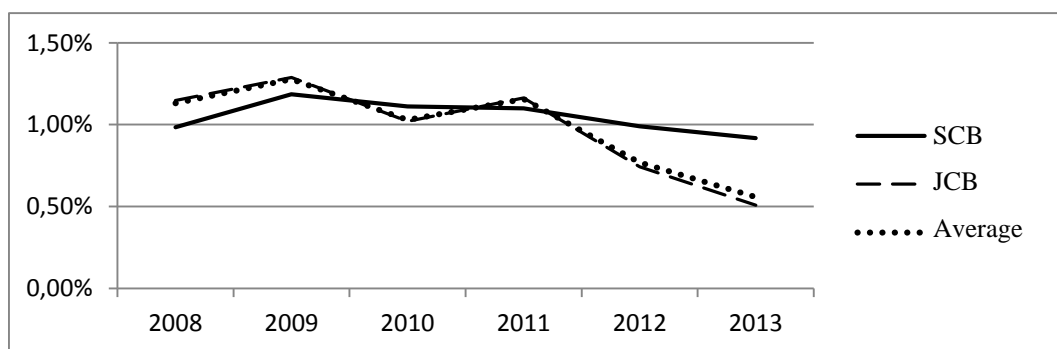
Table 6

Average ROA of banks in the 2008–2013 period

	2008	2009	2010	2011	2012	2013
SCB	0.98%	1.18%	1.11%	1.10%	0.99%	0.92%
JCB	1.15%	1.29%	1.02%	1.16%	0.74%	0.51%
Average	1.13%	1.28%	1.03%	1.16%	0.77%	0.56%
Max	3.73%	3.95%	1.59%	3.72%	1.89%	1.47%
Min	0.05%	0.14%	0.16%	0.00%	0.01%	0.02%

Source: Calculations from banks' financial statements

The use of high financial leverage along big assets has been a prime cause of low ROA in the banking sector. Average ROA of commercial banks was around 1%, but this figure fell to 0.77% and 0.56% in 2012 and 2013 respectively (see Table 6 and Fig. 6). Also in 2012–2013, ROA of private joint-stock commercial banks was lower than that of state-owned ones. Most banks with low average ROA over years (around 0.5%) featured those which have been in restructuring processes such as SCB, PNB, MHB, and NVB. The main reasons are increasingly difficult business, high operating expenses and main income sources of banks almost coming from credit operations. In 2012 and 2013 lending rates decreased. In addition, other costs relating to capital mobilization of commercial banks, despite decreasing borrowing interest rates, highly increased, and thus the costs for mobilization could not be down.

**Fig. 6.** ROA of banks in the 2008–2013 period

Source: Data summary from surveyed banks

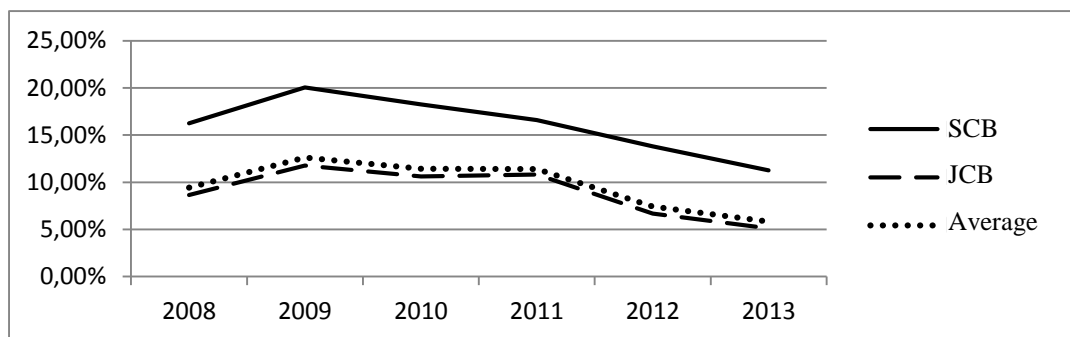


Fig. 7. ROE of banks in the 2008–2013 period

Source: Data summary from surveyed banks

Table 7 and Fig. 7 indicate that average ROEs of banks were relatively high over the years 2008–2013, when ROE of state-owned banks was higher than that of private joint-stock ones. Just like average ROA, average ROE had a tendency to decrease to 7.42% in 2012 and 5.84% in 2013. Such many private banks as SCB, PNB, NVB, and VIB in 2013 revealed their ROEs lower than 1%, which was a very low ratio, even lower than banks’ deposit interest rates. Now, with borrowing interest rate of around 5%–6%, this average ROE does not prove the attraction of banking sector for investors.

Table 7

Average ROE of banks in the 2008–2013 period

	2008	2009	2010	2011	2012	2013
SCB	16.25%	20.04%	18.27%	16.60%	13.80%	11.26%
JCB	8.63%	11.76%	10.63%	10.80%	6.68%	5.10%
Average	9.42%	12.62%	11.42%	11.40%	7.42%	5.84%
Max	28.46%	23.61%	22.08%	26.82%	18.35%	15.09%
Min	0.47%	4.21%	2.45%	0.00%	0.07%	0.32%

Source: Calculations from banks’ financial statements

4.2.5. Liquidity indicators

Lack of liquidity implies that banks are in unhealthy situations or run into many difficulties, causing them to easily be in danger of being hit with massive withdrawals by depositors or even going bankrupt besides far-reaching traumatic effects on the

whole banking system. Liquidity of commercial banks is reflected through current ratio, liquid asset ratio, and loan-to-deposit ratio, as illustrated in the following figures 8, 9, and 10.

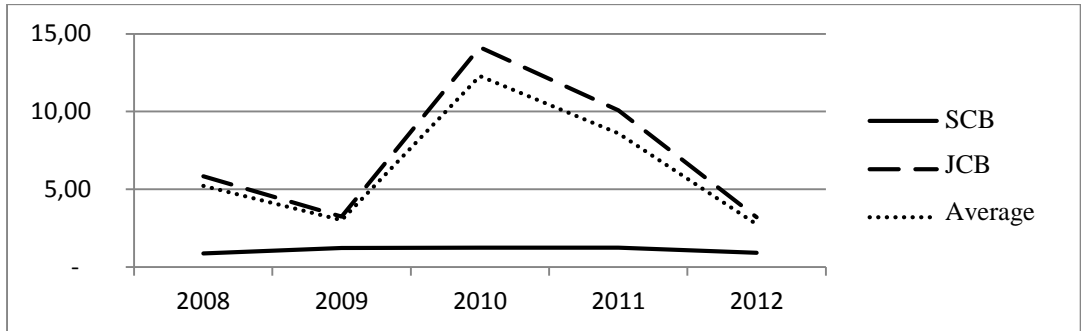


Fig. 8. Current ratios of Vietnam's commercial banks
(Unit: times)

Source: Data summary from surveyed banks

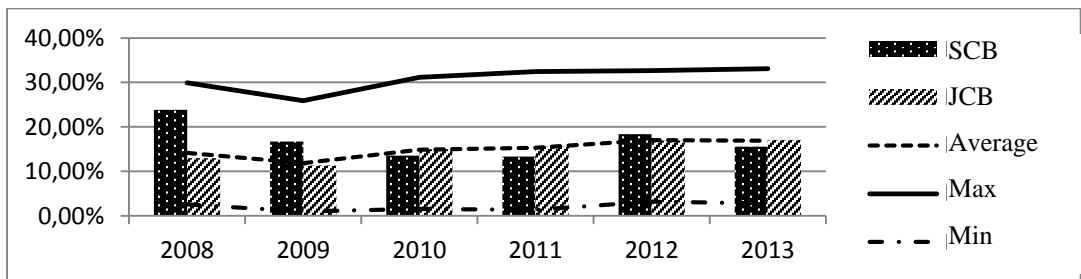


Fig. 9. Liquid assets/total assets of Vietnam's commercial banks in the 2008–2013 period

Source: Data summary from surveyed banks

The current ratios of commercial banks were different. Specifically, the ratios of joint-stock commercial banks were always higher than those of state-owned ones (there was especially a great difference between them in 2010). Yet, in general, banks' current assets were much higher than their current liabilities, which implied two perspectives: First, it was banks' liquidity that was ensured. Reality in recent years has shown that capital flows to banking sector, in spite of constantly decreasing borrowing rates, remained abundant even though the outputs of capital flows seemed to be in genuine hardship. In addition, liquidity distress remained no more a concern, so another case to be taken account of should be bank's inefficiency in their use of the raised capital, which was enormously contributed to liquid assets, thereby leading up to a reduction in average

profitability. Furthermore, liquid assets could be the assets to be adopted to meet liquidity demands, including cash items and other types of available-for-sale securities. Banks with high liquid asset reserves are secure in liquidity, yet their profitability would be of low rates.

The ratio of liquid assets to total assets of Vietnam’s commercial banks has been at relatively stable levels of 14%–15%, and there was not much difference in this ratio between state-owned and private joint-stock banks over the period of 2008–2013. Not a high ratio of this kind may signal risk when there exists an asymmetry between terms of payment (lending terms are longer than deposit terms; liquid assets are far less than those acquired from the raised sources).

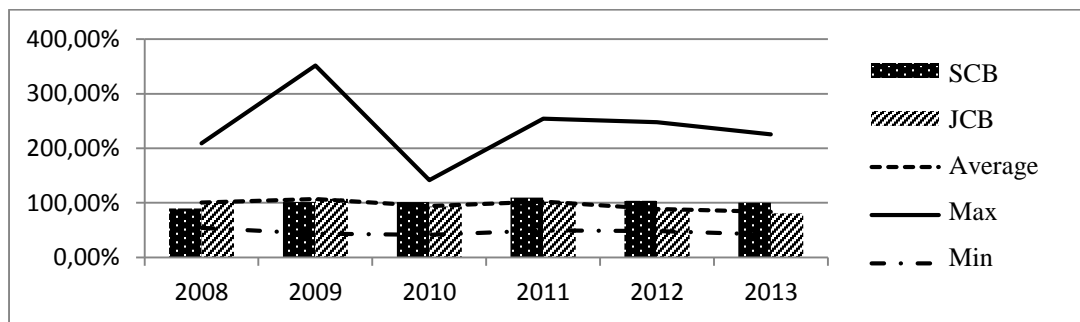


Fig. 10. Loan-to-deposit ratio of banks in the 2008–2013 period

Source: Data summary from surveyed banks

The loans-to-deposit ratios of commercial banks were also at high levels while high current ratios forced them into the reconstruction of portfolio and duration of items. Focusing on loan items could create big profitability rather than on other kinds of assets, but it implies a very high chance of risk: if business environment is disadvantageous, it leads to customer’s inability to pay debt. In the period when annual statements of banks were published, there were many banks with the loan-to-deposit ratios of greater than 100% (see Fig. 10), which demonstrates the imbalance between the use of capital and capital sources.

4.2.6. Market risk (interest rate risk) indicators

Assets of a bank are all related to market risk at different levels. If the structure of bank’ assets covers a great ratio of sensitive assets to sensitive liabilities, it may signal bank’s vulnerability.

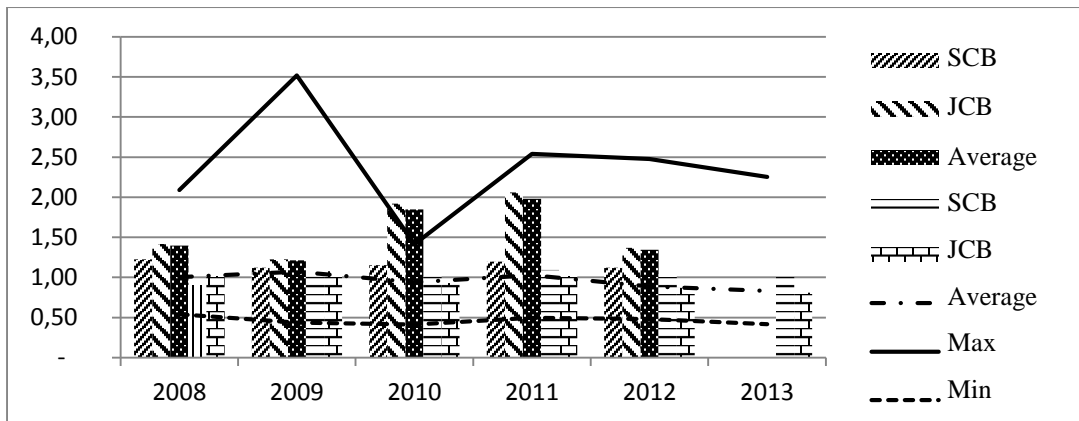


Fig. 11. The ratio of interest rate sensitive assets to interest rate sensitive liabilities

Source: Data summary from surveyed banks

Average interest rate sensitive ratios of banks were greater than 1 over years 2007–2012 while this figure was lower than 1 in 2013. Thus, in theory, commercial banks will reap benefits when there is a trend in interest rate increase due to the fact that interest income may show higher increases than interest expense. In reality, however, interest rates on Vietnam's market tend to decrease, which means that a greater decrease in interest income than that in interest expense would be experienced by commercial banks.

5. Conclusions and recommendations

5.1. Conclusions

Through the analysis of performance of Vietnam's commercial banks, several conclusions can be drawn as given below:

Firstly, in the 2005–2013 period, the size in total assets and equity of commercial banks in Vietnam increased. Over the years, banks have increased in size on the one hand but decreased in quantity on the other hand, which is caused by the project of reconstruction of credit institutions implemented by State Bank in 2011–2015, requiring some banks to be acquired or merged.

Secondly, the majority of banks have completed a quota on CAR of 9% according to SBV's regulations. However, CAR has declined since 2007. The main reason is that total assets of banks have increased more rapidly than their core capital growth rate. Since 2007 the scale of total assets has reached such a great expansion that the core capital

growth rate cannot keep pace with, which causes a declining trend in CAR of some banks. This is a warning of risk outweighing total assets of which banks should be aware to make appropriate adjustments to profits.

Thirdly, the rate of non-performing loan of the whole banking system reaches an average of nearly 4% and tends to increase, which signals poor management of asset quality.

Fourthly, employed to measure management capacity of Vietnam's commercial banks, the expense-to-revenue ratio is not high. This ratio of most commercial banks, in 2008–2013, reached an average of over 80%, and around 100% was the figure also reflected by some of them.

Fifthly, banks' profitability has been low in recent years. ROA stayed around 1% but had a tendency to sharply decrease by 0.77% and 0.56% in 2012 and 2013 respectively. ROE, in addition, also fell steadily to 7.42% in 2012 and 5.84% in 2013.

Sixthly, the liquidity is demonstrated by high current ratio which put Vietnamese banks into the reconstruction of portfolio and duration of items. Meanwhile, the loan-to-deposit ratio is also very high (from 90% to over 100%), which indicates the imbalance between capital sources and the use of them, leading to liquidity risk.

Lastly, the ratio of interest rate sensitive assets to interest rate sensitive liabilities of commercial banks in Vietnam applied to measure market risk is mostly greater than 1 on average over the years. Theoretically, this result shows that banks will benefit from the increasing trend in interest rates because interest income will be higher than interest expense. Yet, real interest rates in the market practically tend to fall down which corresponds to a drop in banks' income as well as their credit performance.

5.2. Recommendations

Through those conclusions, some recommendations are put forward to facilitate the enhancement of Vietnam's banking efficiency and mitigation of banking risk.

Promoting factors that facilitate profitability growth and enhance performance – modernizing banking technology: In the course of globalization and strongly developing knowledge-based economy and technology, the economic development is mainly based on knowledge and technology. In addition to financial and personnel capability ensured to evade the possibility of their becoming further hindrance to banks in modernization

of banking business, legal framework should be sufficiently beneficial to the safe and efficient development of technology.

Reducing factors that confine profitability – resolving non-performing loans: Non-performing loan is now a perplexing puzzle confronting Vietnam's commercial banks, and resolving it as well as increasing financial soundness should be well noted as non-performing loans should imply bankruptcy of the banking system. The bad debt burden is subject to an increase in banks' expenses and reduction in capital mobilization and lendings in the economy. Additionally, non-performing loans also cause public trust in the banking system and its international prestige to turn down. In addition to clearing up banks' balance sheets by resolving non-performing loans having existed for many years, it may be desirable for banks to find out measures that prevent the future development of non-performing loans. Initially, resolution of non-performing loans requires that these be classified and measures be taken to completely resolve each type: non-performing loans that can be sold to Vietnam Asset Management Company (VAMC) or even to foreign investors should be well done that way; and non-performing loans impossible to be sold require that bank owners increase capital sources and enhance provisions of collectible items in order to finish off non-performing loans. Also, new non-performing loans should not arise out of bank's measures to tighten credit underwriting and to determine the procedures of debt collection as well as implement such.

Managing operating expenses: Operating expenses have a significant effect on bank's profitability, yet the ratio of operating expenses to operating profits of Vietnam's banks is still high. To reasonably reduce expenses without affecting the profits, banks need to reorganize the structure of their human resources. Expenses for wages are gaining a high proportion of banks' total operating expenses. Hence, restructuring of banking operations is the best way to enhance banks' performance. In addition, banks should focus on improving the quality of human resources rather than the quantity. Higher banking performance would result from further well-skilled and more productive staff, which may then reduce operating expenses.

Recommendations on risk reduction to the system of Vietnam's commercial banks: Risk management is not always an easy task, which demands much experience and ability to assess situations from banking managers and bank management agencies. Since efficiency of measures for risk reduction greatly depends on their applicability in reality, the paper recommends three main solutions: (1) promoting positive effects of

diversification in profit resources by a much-needed boost given to non-credit services; (2) monitoring risk in each banking activity, establishing strict procedures for risk control with monitoring instruments and customer trust ratings; and (3) uplifting the quality of state management in economic and banking activities. Specifically, SBV needs develop essential quantitative instruments that measure real capacity of each commercial bank, thereby offering suitable credit growth levels for each bank. Moreover, SBV should apply CAMELS and BASEL indicators into monitoring banks' activities in order to reduce risk for the whole banking system ■

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