Introduction

Before the Doi Moi reforms in 1986, Viet Nam’s economy was devastated by 30 years of warfare with two major military powers, France and the US, ending in 1975. In the subsequent 10 years, Viet Nam suffered from failing economic experiments, including agricultural cooperatization, “industry-commerce rehabilitation,” price-wage-currency reform, among others, under the centrally planned mechanism (Wood 1989), as well as the international isolation and a US trade embargo when its troops entered Cambodia to overthrow the Khmer Rouge (Riedel and Turley 1999). Its per-capita gross domestic product (GDP) declined to USD 97 in 1989 whereas the ratio of external debt to GDP reached 330%.1 The economy languished and became one of the poorest in the world (VGP 2016).

Things have since changed. With a population of 92 million, its GDP was USD 204 billion in 2015, after 30 years of socio-economic transitions. Doi Moi has enabled the marketization and internationalization of the economy, bringing about the fruits of the market (Dutta 1995; Riedel and Turley 1999), with the financial system facilitating the transformation (Siregar 1997). The banking system then had total assets of USD 307 billion, about 150% of GDP.

Economic foundations and governance framework

Economic foundations

With 2015 per-capita GDP of approximately USD 2,300, Viet Nam has become a lower-middle-income country. Households have more money to spend and invest as the gross domestic savings ratio remains high, at around 30% of GDP (Figure 12.1). Improved savings ratio in turn helps to counter future economic shocks (Sepehri and Akram-Lodhi 2005).

Foreign direct investment (FDI) facilitated transformations with financial resources, technologies, markets, and new business methods. The stock of FDI-capital realizations by 2015 totaled USD 139 billion, while 2,013 new FDI projects were licensed in 2015 with the new capital registration worth USD 22.76 billion (Figure 12.2). Figure 12.2 shows an evolution of changing FDI projects licensed (vertical axis) and new capital registration (radius of data point) since 1990.
Financial markets had been virtually non-existent before 1990, although money, bank deposits, and loan transactions did exist. With financial reforms this component economy has grown fast (Román 1995). Over time, the State Bank of Viet Nam (SBV) has also built up national foreign reserves that are regarded as *coussin-de-sécurité* against economic shocks that tend to occur frequently in an open emerging economy (Figure 12.3).
Governance framework

Along with the process of reforms, new regulations constitute the governance framework required for achieving strategic goals. The transition period has made lawmaking and enforcement particularly challenging. There are different promulgators in Viet Nam: the Politburo; the National Assembly; the president, the government/prime minister, ministries, and ministerial-level agencies; and the SBV. Legal documents consist of resolutions, laws, circulars/decisions/directives, and decrees. The regulatory framework that governs the financial economy has been built up over the past 10 years (Table 12.1), of which the SBV has issued a relatively large number of regulations. These are important for regulating a large spectrum of financial activities.

Table 12.1 Legal documents governing financial system of Viet Nam

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Govt/PM</td>
<td>46</td>
<td>36</td>
<td>16</td>
<td>6</td>
<td>11</td>
<td>16</td>
<td>3</td>
<td>6</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>SBV</td>
<td>94</td>
<td>106</td>
<td>103</td>
<td>35</td>
<td>57</td>
<td>50</td>
<td>49</td>
<td>87</td>
<td>55</td>
<td>23</td>
</tr>
<tr>
<td>NA</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>3</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ministries</td>
<td>3</td>
<td>34</td>
<td>3</td>
<td>9</td>
<td>4</td>
<td>16</td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>0</td>
</tr>
</tbody>
</table>

The contemporary history

With *Doi Moi* and a two-tiered banking system, the financial system was to fight late-1980s inflation. The battle was continuing well into the early 1990s. In 2010s, once again inflation plagued the economy. Important events of Viet Nam’s financial system are summarized in Table 12.2. Correlated with the pace of inflation and economic expansion, the process of monetizing Viet Nam’s economy started in the early 1990s, and accelerated in the mid-2000s, when the equity market boomed, leading broad money supply (M2) to surge (Figure 12.4), standing at USD 267 billion at 2015 year-end.

In 1986, total credit supply jumped to 1,897% of the 1976 level. The surge continued, and credit supply in 1990 was 4,361% of the 1986 amount. Without proper measures, this monetizing

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986–1987</td>
<td>Launching <em>Doi Moi</em> at the Sixth National Congress of the Communist Party of Viet Nam.</td>
<td>Recognizing/legalizing different economic ownerships in Viet Nam’s economy; Passing Law on Foreign Investment</td>
</tr>
<tr>
<td></td>
<td>• Banking reforms started with the birth of a two-tiered banking system, introducing a central bank and a system of four state-owned commercial banks (SOCB) into the economy. Ordnances on the SBV and commercial banking issued.</td>
<td>• 26/3/1988: Decree 53/HDBT to “transform the banking system.” SBV was consolidated to manage the monetary/credit and credit institutions. State Treasury was spun off from the SBV. Four SOCBs focused on commercial specializations (Decision 403-CT). Positive real interest rate policy implemented.</td>
</tr>
<tr>
<td></td>
<td>• Chain collapse of credit cooperatives.</td>
<td>• Thanh Huong credit scandal broke out in March 1990 as a consequence of mass borrowings by Nguyen Van Muoi Hai, via a large system of 900 money-receiving outlets, offering 12%–15% interest rate/month during 1987–1989. A chain collapse occurred, causing an irrecoverable loss of VND 37 billion (0.235% of 1989 GDP).</td>
</tr>
<tr>
<td></td>
<td>• Amended Constitution 1992.</td>
<td>• USD 55 million grant and USD 85 million loans arranged for Viet Nam to pay its USD 142 million arrears to IMF since 1985.</td>
</tr>
<tr>
<td></td>
<td>• Birth of joint-stock commercial banks (JSCB) and foreign-owned commercial banks (FOCB) following Law on Credit Institutions 1990</td>
<td>• IMF approved a USD 233 million loan.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Paid off USD 13.5 million arrears to ADB.</td>
</tr>
<tr>
<td></td>
<td>• IMF restored Viet Nam’s borrowing eligibility after an eight-year suspension.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• WB granted loans of USD 320 million through IDA.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• ADB granted USD 76 million.</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Events</td>
<td>Remarks</td>
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<td>----------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1994–1995</td>
<td>Lifting of the US trade embargo and normalizing diplomatic relations</td>
<td>Reintegrating into the world economy. IMF, WB, and ADB opened offices. Donors community became active.</td>
</tr>
<tr>
<td></td>
<td>with the US; Becoming member of ASEAN.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>financial crisis.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exchange/HOSE).</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>Opening HaSTC (today's Hanoi Stock Exchange/HNX). The 2nd Vietnamese</td>
<td>USD 750 million bond issue; rate of 7.125%.</td>
</tr>
<tr>
<td></td>
<td>government bond offering internationally since Doi Moi.</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>Stock prices surged, leading to overoptimistic sentiment and high P/Es.</td>
<td>HSBC and ML “bullish reports” about VSM prospects released, triggering stock market fever.</td>
</tr>
<tr>
<td>Post-WTO</td>
<td>Viet Nam joining WTO. HOSE reached the historic height.</td>
<td>USD 10.2 billion of foreign portfolio investment (FPI) flooded during 2006–2007 without proper sterilization. HOSE VNIndex peaked at 1,171 on 12/3/2007.</td>
</tr>
<tr>
<td>2007</td>
<td>2-digit inflation recurred.</td>
<td>12.6% (2007); 19.9% (2008). Decision 131/QD-TTg subsidizing borrowings costs by 4% max.</td>
</tr>
<tr>
<td></td>
<td>2009Q1.</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>Vinashin's default on its financial obligations to international</td>
<td></td>
</tr>
<tr>
<td></td>
<td>lenders.</td>
<td></td>
</tr>
<tr>
<td>2011–2012</td>
<td>Struggled to control credit growth below 20%, and M2 growth below</td>
<td>Inflation: 11.75% (2011); 18.13% (2012). Policy rate jumped from 9% to 11% (17/2/2011), then 12% (1/5/2011).</td>
</tr>
<tr>
<td></td>
<td>16%; two-digit inflation recurred.</td>
<td>6/2012: SBV removed interest rate cap, liberalized interest rates. Vinalines on the verge of bankruptcy.</td>
</tr>
<tr>
<td></td>
<td>CEO and Chair arrested.</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>VAMC created.</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>External debt: USD 72 billion.</td>
<td>38.6% GDP</td>
</tr>
<tr>
<td>2015</td>
<td>State budget showed signs of stress.</td>
<td>MPI Minister stated needs of renewed reforms.</td>
</tr>
<tr>
<td>2016</td>
<td>AEC officially came into existence.</td>
<td>ASEAN regional economy: 660 million population; USD 2,500 billion GDP.</td>
</tr>
</tbody>
</table>

Source: Compiled by the author from numerous government, WB, IMF, ADB, and media sources.
Figure 12.4  M2/GDP (1995–2015)

GDP = gross domestic product.


process led to a high inflation period of two and three digits. Most counter-inflation measures employed then were ad hoc reactions, not without negative consequences. Early adoption of so-called monetary policy measures only started in 1991, having learned the market-based economic mechanism the hard way: slower money velocity could help weather hyperinflation, given certain economic conditions. A significant slowdown in credit growth then followed.

In 1990s, this critically important task has been performed through a two-tiered banking system, with the SBV in the command, and the state-owned commercial banks (SOCBs) and/or joint-stock commercial banks (JSCBs) playing the role of market performers. Credit growth went down to 70% in 1992, and 27.5% in 1999, helping reduce inflation from about 400% in 1988, down to 67.5% (1991), then 17.5% (1992), and then 0.1% (1999).

Institutions; markets; instruments

Institutions

The most important types of financial institutions are presented in Figure 12.5 and Table 12.3.

The financial system in Viet Nam has been bank-based, with 80% of financial intermediation conducted by a handful of powerful banks. But banks resources had been limited until mid-2000s with size of the banking sector being modest, with M2/GDP standing below 80% (Figure 12.4), while Thailand and Malaysia had M2/GDP over 100% in 2000 (ADB 2014). In 2015, the banking sector accounted for 92.25% of total financial assets.

People’s Credit Funds (PCF) resemble credit cooperatives in terms of social traits, but with market principles and joint-stock ownership. They are particularly suitable for delivering rural microfinance. At present, the system of PCFs collectively has total equity of USD 140 million, and total assets USD 3,545 million. Non-bank financial institutions, PCFs included, accounted for 8.5% of total assets in 2016.
Financial Institutions System

Banking sector

State-owned banks
Social policy banks
Joint-stock banks
Foreign banks
People’s Credit Fund

Non-bank financial institutions

ETFs
Securities companies
Insurance companies
Leasing companies
Investment funds
Development funds

Figure 12.5 Viet Nam’s financial system structure
ETFs = exchange-traded funds.

Sources: Author and Vuong and Associates.

Table 12.3 Financial institutions in Viet Nam

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>SOCB</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>SPB</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>JSCB</td>
<td>39</td>
<td>34</td>
<td>39</td>
<td>37</td>
<td>31</td>
</tr>
<tr>
<td>FOCBs – Branches</td>
<td>26</td>
<td>31</td>
<td>44</td>
<td>48</td>
<td>55</td>
</tr>
<tr>
<td>FOCBs – 100%</td>
<td>NA</td>
<td>NA</td>
<td>2</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>FOCBs – Joint Ventures</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>People’s Credit Funds (PCFs)</td>
<td>959</td>
<td>–</td>
<td>–</td>
<td>906</td>
<td>–</td>
</tr>
<tr>
<td>NBFI – Financial Cos.</td>
<td>7</td>
<td>8</td>
<td>22</td>
<td>18</td>
<td>17</td>
</tr>
<tr>
<td>NBFI – Financial Leasing Cos.</td>
<td>8</td>
<td>8</td>
<td>12</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>Securities Companies</td>
<td>8</td>
<td>15</td>
<td>87</td>
<td>105</td>
<td>81</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>18</td>
<td>29</td>
<td>38</td>
<td>38</td>
<td>61</td>
</tr>
</tbody>
</table>

SOCB = state-owned commercial bank, JSCB = joint-stock commercial bank, FOCB = foreign-owned commercial bank, JV = joint-venture, NBFI = non-bank financial institution, SPB = social policy bank.

Note: NA: not applicable; – : not available.

Sources: SBV, MoF.
Markets and instruments

Credit markets and products

The banking industry has been dominated by four SOCBs: Vietcombank, BIDV, VietinBank, and Agribank. They are largest in terms of equity and assets (Figures 12.6 and 12.7). The second “family” consists of 31 JSCBs. Tier-1 JSCBs were founded during 1992–1993 with such names as ACB, Eximbank, Sacombank, VPBank, and Techcombank.

![Banks’ capital aggregates by ownership](source: SBV)

![Bank assets by ownership](source: SBV)
During 1990–1996, the SBV issued licenses for 20 rural areas commercial banks. Following SBV Decision 1557/QD-NHNN (9/8/2006), rural banks, if satisfying financial and operational conditions, may be “converted” to normal JSCBs and allowed to conduct business in urban areas. Most of them formed the tier-2, although some moved up the value chain and have become stronger and sizeable (e.g., HDBank).

After the US-Viet Nam bilateral trade agreement in 2001, and 2007 WTO membership, Viet Nam’s banking market has opened to FDI and FPI, leading to a surge in foreign banks’ operation in the domestic market.

Since 2005, the SBV has required banks to maintain a minimum 8% capital-asset ratio, defined by total equity/total risky assets. Banks then rushed to issue shares to shore up their capital base. By the end of 2006, most banks had equity three times of the 2004 level.

Figures 12.7 and 12.8 show although total assets of SOCBs have still been the largest in the system, JSCBs collectively have become larger, and on par with SOCBs.

There are also special entities, established to serve the development and poverty reduction programs, namely Viet Nam Bank for Social Policy, Viet Nam Development Bank, and Cooperative Bank of Viet Nam.

Domestic commercial banks have been able to increase their equity base thanks to public offerings on the Viet Nam Stock Market (VSM). Since 2005, banks have collectively raised the additional equity amount of USD 13 billion. In 2015 the capital adequacy ratios were 9.4% for SOCBs, 12.7% for JSCBs, and 33.8% for foreign-owned commercial banks (FOCBs).

Banks’ profitability and investment efficiency have generally been considered modest, and showed some sign of decline in recent years, with ROEs in 2014 standing at 6.92% for SOCBs, 4.64% for JSCBs, and 3.79% for FOCBs. ROA was 0.53% for SOCBs, 0.40% for JSCBs, and 0.61% for FOCBs.

The development of the banking sector is correlated to the expansion of credit supply to the economy. Credit-to-GDP ratio was 71% in 2006 and 116% in 2010. On average, annual credit growth was 33% during 2006–2010. In this period, FDI and foreign portfolio investment (FPI) inflows surged abruptly, adding a lot of liquidity to the economy. In 2007 alone, USD 17.7 billion flowed in,

![Figure 12.8 Shares of bank assets by ownership](image)

Source: Author’s compilation/Vuong and Associates.
leading to SBV net forex purchase of USD 10.2 billion. Without being sterilized properly, M2 surged by 46% in the year, creating a tremendous inflation pressure. For fighting inflation, the rate dropped to 11% in 2011, and 9% the next year, choking off the credit flows and causing tens of thousands of firms to collapse each following year. After years of restrictive monetary-policy measures, credit growth rate was 18% in 2015 when M2 and deposits expanded by about 14% (Figure 12.9).

Banks also earn their incomes from forex operations, thanks to fluctuations in forex rates (Figure 12.10) and increasing transaction volumes. Vietnamese individuals are allowed to keep foreign currency deposits, mostly US dollars, at banks. A high foreign currency deposits/M2 ratio reflects the “dollarization” issue, which varied from 5% during 1992–1996, to 19% (2000–2001), 15% (2008–2009), 20% (2010), and 15% (2011–2015).

In addition, banks have expanded retail banking to reach out to individuals with more bank cards, ATMs, and POS. Domestic debit cards and ATMs appeared first in 1993, and

![Figure 12.9 Credit growth (percentage/year)](image)

*Source: SBV.*

![Figure 12.10 USD-VND exchange rate, 2003–2016](image)

*Source: OTC-Interbank.*
international credit cards in 1996. But ATM/POS became popular only in 2003, when the number of cards nationwide reached 234,000. Electronic banking activities have since flourished, with 31.7 million cards in 2010 and 88.21 million in 2015.

**Viet Nam Stock Market**

The Viet Nam Stock Market (VSM) consists of two stock exchanges: Ho Chi Minh Stock Exchange (HOSE), established in July 2000; and Hanoi Stock Exchange (HNX), established in July 2005. Figure 12.11 shows the evolution of two widely cited market indexes during 2005–2015 (VNIndex/HNXIndex), where average price/earning for HOSE peaked at 50–70(X) during 2007–2008, and plunged to 8(X) in 2011. As of 2015 year-end, this ratio stood at 9 and 11(X) for HNX and HOSE, respectively.

In mid-2016, VSM had 312 joint-stock companies listed on HOSE and 388 on HNX. Both size and liquidity have grown over time. In 2005, the average daily trade volume was less than 700,000 shares, and the figure increased to 2.6 million in 2006, and 18 million in 2008. In 2014, the VSM saw the largest yearly trade volume of 47.4 billion shares, worth USD 35 billion (Table 12.4). In 2016Q1, the average value was approximately USD 100 million/day.

![Figure 12.11 VNIndex (HOSE) and HNXIndex](source: Compiled by author with data from Ho Chi Minh City Stock Exchange.)

**Table 12.4 Liquidity on VSM, 2011–2015**

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade volume (billion shares)</th>
<th>Trade values (VND billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HOSE</td>
<td>HNX</td>
</tr>
<tr>
<td>2011</td>
<td>18.88</td>
<td>7.94</td>
</tr>
<tr>
<td>2012</td>
<td>–</td>
<td>12.14</td>
</tr>
<tr>
<td>2013</td>
<td>16</td>
<td>10.57</td>
</tr>
<tr>
<td>2014</td>
<td>30.45</td>
<td>16.98</td>
</tr>
<tr>
<td>2015</td>
<td>28.13</td>
<td>11.54</td>
</tr>
</tbody>
</table>

Source: HNX data.
The VSM’s market size grew quickly during 2006–2015, with 2015 year-end market capitalization standing at 33% of GDP (Figure 12.12). The VSM performs better now than in the pre-World Trade Organization (WTO) period in terms of both IPOs and seasoned offerings. Firms have issued shares worth about USD 100 billion in VSM’s first 17 years. During 2010–2015, USD 53 billion was raised, of which the total value of funds raised reached USD 13.2 billion in 2015, about 28% of Viet Nam’s total capital expenditures. In addition, the VSM helped to attract about USD 15 billion of FPI.

Figure 12.12  VSM market capitalization (percentage of GDP)
Source: Author’s compilation from SSC/HOSE/HNX reports.

Figure 12.13  Government bonds (outstanding)
Source: ADB/AsianBondOnline (23 March 2016).
Financial economy of Viet Nam

Bond markets
From 2005, the VSM has also served as a major distribution system of government bonds, with the HNX being authorized to organize public auctions. The government borrowed from public bonds investors approximately USD 48 billion in 2010–2015, mostly with tenures of three and five years. In 2011, the bond market was worth 15% of GDP, with over 90% being government bonds. Total value of outstanding government bonds is now estimated 22% of GDP, making them a major source for financing state budget deficit. While the government bond market has been picking up since 2005, the corporate bond market remains quite modest, about VND 42.8 trillion (USD 1.92 billion) in 2015, according to the HNX. In fact, the corporate bond is the game where few large corporations – banks included – dominate and seek to tap public sources of debt finance.

Securities broker firms
The number of securities companies grew with VSM’s size. Dozens of securities broker firms have made their fortune on VSM, especially those with strong equity and dominating market shares. The 10 most active broker firms in HNX occupied more than 62% of market share, while they also took 67% of HOSE brokerage fees in 2015. About 800,000 stock trading accounts were registered with the Viet Nam Securities Depository Center (VSD) in 2009, a substantial increase from 530,000 in 2008. But in March 2016, the VSD already counted 1.48 million trading accounts.

High inflation and restrictive monetary policy caused brokerage firms to make a substantial loss in 2011. In 2014, surviving firms were able to improve their performance, and their collective profits jumped to USD 150 million. The sector’s ROA and ROE were 5.15% and 8.58%, respectively in 2014, twice of those of 2010.

By the end of 2015, only 81 firms survived the fierce competition who collectively held total assets of USD 3,395.5 million, and total equity of USD 1,891 million. Among them, the 20 largest made total revenues of USD 345.5 million, and profits of USD 131.8 million.

Figure 12.14  Financial aggregates of the insurance industry

Source: DIMA.
**Insurers/insurance markets**

Before *Doi Moi*, the insurance business had been monopolized by Bao Viet Insurance, an SOE established on 17 December 1964 offering two dozen basic insurance needs. Changes came with Decree 100/CP (18/12/1993), which allowed private and foreign firms to participate. The scope of activities also expanded. The market boomed in 1995 when dozens of new insurance firms, including joint ventures, were licensed. Additionally, 40 foreign insurers’ representative offices and about 70,000 insurance agents were approved. Nowadays, 61 insurance and related service firms are fully operational in Viet Nam, offering 800 different products meeting almost every consumer’s need.

It is also noteworthy that six life insurance businesses have been offering pension products – namely Manulife, AIA, Daiichi, PVI Sun Life, Bao Viet Life, and Prudential. Conventional nonlife insurance needs are mainly served by domestic firms with PetroVietnam Insurance occupying the largest share due to the surge of risky oil exploring/mining activities during 1995–2015.

In 2015, total insurance revenues reached USD 3.13 billion, representing an annual growth of 21.43%, of which nonlife took USD 1.46 billion, and life USD 1.67 billion. Revenue growth for life insurance was at 29.5%, outpacing nonlife, 14%. Insurers also honored total financial obligations worth USD 955 million.

Total assets of the insurance sector stood at USD 8.78 billion in 2015, a 12.68% annual growth during 2011–2015, of which, nonlife subsector accounted for 31.8%, and life 68.2%. Total revenues of 12 insurance broker firms also reached USD 26.8 million in 2015, representing a 14.3% annual growth.

Insurers also reinvest into the economy, with total 2015 stock worth USD 6,383 million, 79.2% of which came from life insurers. They are the main buyers of government bonds, with total purchases reaching USD 283 million in 2015.

With over 200,000 registered agents, life insurers increased new policies sold during 2013–2015: 1,178,390; 1,252,157; 1,298,776. Industry experts expect the life insurance market to annually expand by 25%, and nonlife by 18%.

**Financial companies**

The first financial companies were licensed in 1997 to provide consumer finance and serve domestic trades. Their collective balance sheets showed an increase of shareholders’ equity from USD 520.8 million in 2012 to USD 815.6 million in 2015; and assets decreased from USD 7.49 billion to USD 4.04 billion.

As non-deposit-taking firms, they are focused on non-bank services, especially riskier consumer goods financing. In the 2014–2016 period, they financed 20% of consumer goods purchases, with interest rates typically running from 25% to 30% per annum, twice the normal bank rates.

**Leasing**

Six financial lessors appeared in mid-1990s, providing small-scaled term-finance alternatives to private small and medium-sized enterprises (SMEs), who then suffered from discriminatory lending by SOCBs. Banks also established their wholly owned financial leasing subsidiaries, as lessors could be more flexible in terms of decision-making. From 2000, the government raised
the bar for new entrants, requiring USD 5 million equity minimum. Lessors then entered a race in equity. Their equity base increased to USD 70.5 million in 2005, and then USD 136.4 million in 2007.

In the post-WTO period, lessors performed poorly, with profit margins declining over time. The industry average ROE was only 3.5% in 2007. Flexible contract terms became dangerous as executives manipulated regulations and made financing decisions for personal profiteering, especially at SOCB-founded lessors such as the case of Vu Quoc Hao – former CEO of Agribank Leasing Co. 2 – who was sentenced to death in an embezzlement trial in 2014.

By 2016Q1, only Vietinbank Leasing, Vietcombank Leasing, BIDV Leasing, ACB Leasing, and Sacombank Leasing remain active while the rest struggle with bad debts and losses.

**Merger and acquisitions market**

Merger and acquisition (M&A) activities started in Viet Nam in the mid-1990s. The risk spillover during the 1997 Asian financial turmoil triggered early transactions such as the merger between Phuong Nam JSCB and Dong Thap Rural JSCB in 1997. The first noteworthy cross-border M&A deal was Colgate Palmolive’s acquisition of Da Lan Toothpaste – then occupying 30% market share – for USD 3 million. But the real surge in M&A activities started in 2006, speculating on Viet Nam’s continuous prosperity post-WTO, with 47 deals completed, worth total USD 0.6 billion.

Larger M&A deals appeared in 2013 with Warburg Pincus’s acquiring 20% of Vincom Retail and KKR’s USD 400 million purchase of Masan’s equity. The market peaked in 2012 and 2015, with total value each year standing at USD 4.2 billion, counting 367 and 525 deals, respectively (Figure 12.1). M&A among domestic firms also increased during 2008–2012, from 22% to 45% of market. Acquiring firms from Japan, Singapore, the Republic of Korea, and the US dominate the market.

![Figure 12.15](image-url)  
**Figure 12.15** M&A transactions in Viet Nam  
*Source: Institute for Mergers, Acquisitions and Alliances (IMAA) and Vuong, Napier, and Samson (2014).*
The relation of banking, finance, and economic growth

Monetary policy and financial sector reform

Implementing more modern monetary policy has helped Viet Nam fight inflation and supported growth (Roman 1995; Riedel and Turley 1999; Camen 2006). But over time, the goals, tools, and implementation processes have shown weaknesses and limitations. For example, management of forex fluctuations has been a burden on SBV/SOCBs, limiting the ability to pursue an independent monetary policy (Pham and Riedel 2012; ADB 2014; World Bank 2014). Also, Pham and Riedel (2012) argue that the conduct of monetary policy in Viet Nam during the higher inflation period was generally “clumsy.” To this end, financial sector liberalization helped not only promote growth but also maintain macroeconomic stability, thanks to more predictable commercial lending rates in the marketplace (Figure 12.16).

Viet Nam’s leadership now considers steps for further liberalizing the financial system, giving more freedom to market players. Although interventions are still unavoidable at times, they are now used more cautiously, and policy-making tends to be increasingly evidence-based.

Viet Nam’s integration into the world economy increases its domestic capital market’s dependence on world markets, which also bring contagion risks. There is evidence that the VSM has been influenced by American, PRC, and Japanese stock markets (Wang and Lai 2014).

Inclusive financing: microfinance, venture capital, crowdfunding

Microfinance

Jobs creation has been a major economic achievement. From mid-1990s, most jobs have been created by private SMEs. The problem with the SMEs subsector has been a constant lack of access to financing and unequal playing field where they are subjected to higher costs of fund and operations (O’Toole and Newman 2012; Yoshino and Taghizadeh-Hesary 2014).

Figure 12.16  Average lending rate (in percentage)

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Kalra (2015) reports only 8% of Vietnamese saved money and 16% had a loan with a financial institution in 2011.

In this context, microfinance has been an important solution and a sign of financial market liberalization, although evidence on its positive effects has been mixed (IFC 2014).

According to the IFC (2014), only 16.5% of the adults in rural areas and 29.8% of adults in urban areas have an account at a formal financial institution as of 2011, whereas the averages for the East Asia and Pacific developing region are 50.1% and 68.7%, respectively.

Although still limited in scale, improvements of MFI activities can be seen with more recent statistics. The three major domestic systems that are partly responsible for microfinance activities, namely Bank for Social Policy, Agribank, and PCFs collectively served 9.6 million clients by the end of 2013, providing a total amount of credit worth USD 8,034 million. By the end of 2012, genuine MFIs (exclusive of VBSP/VBARD/PCFs) provided USD 108 million micro-credit to 480,000 clients (IFC 2014). This cause of sustainable development – supported by multilateral organizations – also leads to microfinance initiatives such as the Asian Development Bank-managed USD 40 million Asian Development Fund program in conjunction with Japan Fund for Poverty Reduction’s technical assistance.2

Venture capital financing

Due to the predominantly credit-based financing agenda by the Vietnamese government, venture-capital activities had a slow start in 1990s, and Viet Nam’s entrepreneurial financing initiatives have significantly diverged from international venture-capital policy patterns (Klingler-Vidra 2014). Today’s best-known venture-capital funds (VCF) include IDG Ventures, Kamm Investment, CyberAgent, DFJ/VinaCapital, IndochinaCapital, MekongCapital, and Viet Nam Partners.

IDG is the pioneer with its presence in Viet Nam dating back to 1992, with IDG financing PCWorldVietnam – its first computer publication. Formally established in 2004, it now holds a USD 100 million portfolio consisting of 42 tech, ICT/media, and consumer-sector companies, including successful projects as VNG, Apollo, VC-Corp, and VietnamWorks.

In 2015, the government explored the opportunity of setting up a VCF to support a newborn ecosystem for tech-related entrepreneurs, with assistance from state-financed sci-tech supports agencies such as NAFOSTED/NATIF/NATEC, Viet Nam Startup Fund, and Viet Nam Silicon Valley Project. The government and its research institutes believe a national VCF will be a prime solution, helping nurture this critically important component of the entrepreneurship ecosystem with seed funding.

Crowdfunding

Crowdfunding has become a buzzword in recent years when entrepreneurs seek to find alternative finances for their creative, yet risky, ideas. It was heard of for the first time in Viet Nam in 2012, but the legal framework for governing crowdfunding operations has not been in place leading to higher perceived risks. Viet Nam finally got the first ever crowdfunding platform IG9 in mid-2013.

Most crowdfunding activities center around a handful of internet-based platforms: including ig9.vn, fundstart.vn, 500.co, inspireventures.com, and cyberagentventures.com. Despite its novelty, local entrepreneurs are receptive to crowdfunding, and on steep learning curves.

The crowdfunding industry has still been nascent, but with a fast growing and dynamic entrepreneurship community, Viet Nam would likely become the second country in ASEAN – after Malaysia – that institutionalizes a crowdfunding framework with a development roadmap.
Inherent risks and challenges

The bank-based nature induces inherent risks of structural problems as at present, total banking assets amount to 180% of GDP, and 92% of total financial assets. During 2005–2010, state institutions increased holdings in SOCBs/JSCBs from USD 70 million to USD 700 million without facing regulatory restrictions (Pincus 2015), although inefficiencies of state-owned non-core investments had been well informed. Meanwhile the inflation problem remains, making the system even more vulnerable to economic shocks (Nguyen, Cavoli, and Wilson 2012; Kalra 2015; Vuong 2016).

Use of credit in Viet Nam has generally been regarded as inefficient. The real estate market consumed 80% of credit supply in 2013, crowding out other productive sectors. More recently, the government’s stimulus package in 2008 induced risk-taking and arbitrage-seeking (e.g., turning to speculative assets), causing irrational bubbles in these connected assets markets (Dinh et al. 2013). The risk of misallocation of financing to three to six times the formal banking rates (Thanh et al. 2011). This is a serious issue for the economy in general (O’Toole and Newman 2012; Vuong 2016). Selfish interests tend to entice banks – currently under interest controls – to protect their margins by transferring operational costs to customers, for instance by imposing fees on numerous lending transactions (Pham 2015).

Another persistent challenge is habitual practices of using a large portion of short-term funds to provide long-term credit, causing mismatch risk and adversely affecting asset-liability management equations. The ratio changed for SOCBs over time from 21.5% (2012) to 25% (2014) and 34% (2016); and for JSCBs: 18%, 21%, and 37%, respectively. The issue appears to worsen even though the size of the banking system has increased significantly, thus a structural issue remains structural!

In reality, the aforementioned risks are reflected through the problem of non-performing loans. Official bad debt ratio (Figure 12.17) is usually regarded by experts as well below international standards, triggering disagreements even among concerned authorities.

The creation of Viet Nam Assets Management Company in June 2013 and its questionable credibility show how serious the problem of bad debts is. The government had planned this for

![Figure 12.17 Bad debt ratio](source: SBV reports.)
about three years, and it finally took three major sub-law regulatory documents to establish it: Decree 53/2013/ND-CP by the government; Decision 843/QD-TTg by the prime minister; and Decision 1459/QD-NHNN by the SBV governor.

Facing these issues, recent positive signs of the banking system such as a lower lending-to-deposit ratio, about 80% during 2014–2016, and positive growth rate of deposits at banks may reduce stress in the financial system for some time, with short-term lending rates going below 10% per annum during 2013–2015 (Figure 12.18). However, there have also been signs of a lower capacity to consume finance within the productive sector. In addition, the increasing society’s liquidity preference becomes phenomenal, representing some doubt over the financial system’s long-run stability.

Reform needs

It is generally agreed that financial reforms have to a large extent supported the transformation of Viet Nam’s economy (Kovsted, Rand, and Tarp 2005; Bayraktar and Wang 2006; ADB 2014; World Bank 2014). However, persistent problems are now putting pressure on renewed reforms (Leung 2009; Pham and Riedel 2012). The following three issues need to be urgently addressed by policy-makers.

The skewness of financial assets by sector and ownership will need to be addressed adequately, as with fast growing assets – now already 200% of Viet Nam’s GDP – all the risks pertaining to the system as discussed will be amplified, making the economy increasingly vulnerable to economic shocks (ADB 2014, 2015). Viet Nam’s financial deepening is high compared to the majority of lower-middle-income countries. Although openness improves the access to financial services and the efficiency of financial intermediaries, its functions of reducing the cost of funds and stimulating capital accumulation/economic growth face serious limitations (Bayraktar and Wang 2006; Vuong and Napier 2014). The opening of the sector alone does not suffice to address the risks (Leung 2009; Pham and Riedel 2012). Renewed reforms of the governance system based on rules of law and arm’s-length-transaction principles will
have to be institutionalized (Malesky and Taussig 2009; Bhattacharya 2014; Pincus 2015). That means a departure from the existing system – primarily based on personal relationships, cronyism, and unchecked commercial interests – with cross-holdings of banks’ equity as a manifestation (Sarath and Pham 2015).

The flaws in making and implementing monetary policy, such as sudden changes of policy rates or putting the brakes on credit flows, are related to the complexity, and most probably the impossibility of its multi-objective macro decision-making framework (Pham and Riedel 2012), thus a reform need is well beyond just fixing the “clumsy policy behavior” (Nguyen and Nguyen 2009; Nguyen, Cavoli, and Wilson 2012; Kalra 2015). The two bouts of two-digit inflation during 2008–2012 remind policy-makers of the problem posed by the so-called impossible trinity (Das 2006; Grenville 2011).

The weaknesses that prevent the economy from attaining its optimal balance between growth and sustainability include an inadequate speed of institutional reforms, macro institutions, and the entrepreneurial ecosystem; as well as a lack of an independent central bank with effective policy-making and efficient set of policy implementation tools, which has the skills, rules, resources and capabilities of balancing between stability-oriented interventions and profitable risk-taking (Camen 2006; Kraay and Nehru 2006; Leung 2009; Volz 2013; Volz 2016).

The SBV’s relative independence will become critical, as compromising on quality of policy-making will ultimately lead to uncontrollable risks and failures to plan even in the short run. As the monetary and capital markets have already been strongly connected and very sensitive even to a vague sign of failures (Bellocq and Silve 2008), monetary policy quality will have far-reaching effects – positive or negative – on the whole economy and its future. Toward such a reform, the value of increasing central bank’s autonomy should ultimately be for public interests and national sustainable prosperity (Stiglitz 2016).

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Notes

1 Financials reported in USD are for comparison while national accounts and market transactions are required by laws to report in Vietnamese Dong (VND).

References

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