

Non-Performing Loan

Case study in Vietnam: causes, consequences, and effects.

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<p>Abstract:</p> <p>Non-performing loans affected the economy in a widespread area, at least during the last decade. The phenomenon had never been a concern until the collapse of stock and real estate markets. Considering that those markets accounted for a massive volume of capital, the crisis quickly spread to banking and commercial lending market.</p> <p>In Vietnam, the non-performing loans have been the concern since 2011. The inefficiency of capital markets humiliated production activities, in general, and competitive capacity, in particular. Immediately, non-performing loans had received massive concerns from investor, domestically and internationally. The concern is not only on a phenomenon of non-performing itself, but also on the interference, and adjustments of the government based on non-performing loans. From those views, non-performing loans are the main component, affecting the economy on macro and micro scale.</p> <p>In this research, researcher hopes to distribute a general look into non-performing loans, including actual explanations for causes, consequences of non-performing loans. Understanding of nature and reality of non-performing loans will allow investors to explain movement and tendency of lending market thoroughly. For further concern about consequences of non-performing loans, the researcher also monitors recent reforms and actions of banking market, as a main consequence. The analysis of non-performing loans is a valuable reference to evaluate the health of financial markets, in particular, and the stability of the economy, in general. Hence, this paper aims at being a hint to investors, especially foreign investors who keep doubtful viewpoint about Vietnam, one of the most emerging markets in Asia-Pacific.</p>	

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Abbreviation

ADB	Asian Development Bank
NPLs	Non-Performing Loans
SBV	The State Bank of Vietnam
SOCBs	State-owned Commercial Banks
SOEs	State-owned Enterprises
WB	World Banks
WTO	World Trade Organization
AMC	Asset Management Company
VAMC	Asset management Company of Vietnam

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FOREWORD

1 INTRODUCTION

1.1 Background

In recent years, from 2007 to 2013, Vietnamese economy experienced impressive growth and expansion. The market, at the time, received a massive concern from foreign investors. However, the economy was still immature, while the development of financial infrastructure was not able to catch up with the needs of the economy, which was in booming growth and expansion. The immature infrastructure of financial systems was both because of the poor technology and the capital capability. After all, the poor credit management was the most problematic challenge. In fact, the participation of Vietnam into World Trade Organization (WTO) in 2007 has erased barriers of the economy. Along with a massive expansion of the economy, the financial market also grew with surprising rate. However, the experience of banks in credit management did not support the development. The crisis of banks in 2010 was clear evidences.

There have been plenty of studies and researches explain the causes of the crisis. One of the notable causes was the non-performing loan, because non-performing loans was a typical signal of the financial crisis in history, at least on the macroeconomic assumption. Additionally, high-interest rate, economic slowdowns, currency exchange rate depreciation can even severely deteriorate the phenomenon of non-performing loans. During history, high non-performing loan ratio was recorded in Korea, Indonesia, Malaysia, and Thailand in 14, 27, 32, and 51 percent, respectively.

While the financial crisis 2007 – 2008 took place in other markets, the banking system in Vietnam was remaining surprising growth. However, many institutions warned that the impressive growth of the capital markets was unsustainable. In fact, capital strongly flowed into the real market, stock market, and state-owned corporations. Besides, the year 2010 experienced the collapses of the real estate market, stock market, and state-owned corporations, which directly damaged asset quality of the banking system. Therefore, the asset quality of lending institutions deteriorated sharply. The threats from deterioration of loan performance appeared.

Hence, the research will be conducted on the theme of the financial crisis, from 2010 to 2012 in Vietnam. Another aspect in favor of the theme of this research is that non-performing loans strongly affected the economy in the widespread area during the time. The study of non-performing loan will be a meaningful reference to investors about the market on a macro scale, especially foreign investors.

1.2 Motivation for topic chosen

The phenomenon of non-performing loans attracted not only the concerns of investors, but also the attention of social science experts. There are many papers discussing the topic, including many different aspects.

In Vietnam, non-performing loans affected the economy in a widespread area, at least during the last decade. The phenomenon had never been a concern until the collapse of stocks and real estate market. Because these markets accounted for massive volumes of capital, the crisis quickly spread to banking and commercial lending market. Soon after, many experts blamed the lending market for weaknesses in many business activities, due to the adverse impact on the stability of capital markets. At certain times, cost of capital came up over 20 (percent). The inefficiency of capital market humiliated production activities and competitive capacity. The capital, in particular, and the banking sector, in general, has received concerns since then, as the initial cause of the downward of the economy. The weaknesses of the banking sector were monitored and analyzed, and people agreed that non-performing loans are the main components. Immediately, non-performing loans have received massive concerns from both domestic and international investors. The concern is not only one phenomenon of non-performing itself, but also on the interference and adjustment of the government based on non-performing loans. From these views, non-performing loans are the main component, affecting the economy on a macro and micro scale.

In this research, researcher hopes to distribute a general look into non-performing loans, including an actual explanation of causes, consequences of non-performing loans. Understandings of nature and reality of non-performing loans will allow investors explain the movement and tendency of the lending market thoroughly. Of further concern about

consequences of non-performing loans, the researcher also monitors recent reforms and actions of banking market, as a main consequence. The analysis of non-performing loans would be a valuable reference for evaluating the health of financial market, in particular, and the stability of the economy, in general. Hence, this paper aims at being a hint to investors, especially foreign investors who keep the doubtful viewpoint about Vietnam, one of the most emerging markets in Asia-Pacific.

1.3 Aims of the research

The research aims at explaining the phenomenon of non-performing loans in Vietnam. The object will be discussed on different aspects, including cause, consequences, and the development of the tendency. Another main contribution of this thesis is the evaluation of banking reform and its mutual effects of other relative markets.

To introduce the reader into the object, the researchers will acquiesce measurements from both the international and domestic institutions, in order to monitor the overall phenomenon of non-performing loans in Vietnam. In this section, causes, consequences and the relationships with other areas of the financial market will be discussed. The latter part, the research will present reforms in banking and financial sector, which are mutually relative to the phenomenon of non-performing in Vietnam. This observation will allow investors to have a better understanding about the operation of capital market.

After all, the researcher will present recommendations for solving non-performing loans from study experiences and approaches of other countries. These approaches will be analyzed according to different criteria, including compatibility with market in Vietnam. Additionally, the cost of the approaches was also under consideration.

1.4 Research Question

Considering that non-performing is a complex object, the researcher will try to narrow the topic to a reasonable limit. The paper will try to answer a number of questions with a certain level of insight.

- What cause the notable rising of non-performing loans in Vietnam?

- How non-performing loans mutually affects different areas of the economy, including lending market, real estate market, and stock market?
- What is the development and tendency of non-performing loans, in particular and the lending market, in general?
- What is the resolution of non-performing loans in Vietnam, including a look into the regulation in the banking sector and the establishment of Asset Management Company of Vietnam (VAMC)?

It is appropriate to restate that the paper proposes to be a reference to the investors about non-performing loans, in particular, and the banking section, in general. The research question, hence, is decided based on the aims of the research. There are, however, the limitations during the research that makes the researcher centralize the content in a reasonable limit. These challenges will be discussed in the limitation section.

1.5 Description of method

The research will fall into categorize of investigation and analysis. Hence, researcher will conduct qualitative research for this paper. For an investigation and analysis research, the researcher applies principles of qualitative research to ensure the coherences, level of distribution, and reliability.

The research is supported by intensive literatures, providing useful hints about the nature of the subject. The researcher significantly referred reports, and frameworks published by prestigious international institutions in the area, including Asian Development Bank (ADB), IAS, etc.

For explaining triggers of non-performing loans at a certain level of insights, researcher will explain the background of the banking section in Vietnam, including the development, the nature, and tendency.

The research is conducted in the theme that similar researches were made in other countries, or in Vietnam, but in a narrow scope. Hence, observations and experiences of other surveys will be referred with respect.

1.6 Limitations

There are limitations that will humiliate the quality of the research. The actual data and measurements published by the State remained distant from estimation international institutions. The inconsistent data and numbers are the greatest challenges for the researcher to approach the phenomenon.

Acknowledged the challenges, researcher's efforts to avoid deductions and analysis, which are based on quantitative research. Hence, the research will be conducted by qualitative method. After all, the purpose of this paper will be investigating and analyzing non-performing loans; the choice of purpose is reasonable.

1.7 Disposition

The paper will be presented as follows:

Chapter one will concisely introduce the background and motivation of the topic chosen. The research will explain the notability of the object; the need of the research is also discussed here. A brief explanation about the limitation and scope of the research is available in this section.

Chapter two will describe previous studies about theory and practical appraisal of "Non-Performing Loans". Explanations and effects of "Non-Performing Loans" are also mentioned in this chapter. In this section, the definition of non-performing loan will be presented. Theoretical frameworks and study from international institutions will be attained as reliable references.

Chapter three describes principles and process of research method chosen. The reason for chosen method is also explained in this section.

Chapter four shows the results of research and discussion around these results. The study will be focused on non-performing loans in Vietnam, including cause, consequences, and the effect on bank transform in Vietnam. The researcher interpreted the weaknesses of capital market both in capability and credit management is the key factor of non-performing loans. Along with limitation coming from the banking system, the decline of other markets, mostly stock and real estate, has exacerbated non-performing phenomenon. About consequences, researcher supposed that non-performing loans have

weakened the capability of the banking system, which has never caught up with the demand of the economy. The crash of the banking system has increased the pressure on the economy, boosting the needs to transform the banking system. Finally, the researcher devoted a special attention to asset management companies (AMCs), a direct solution for non-performing loans in Vietnam. In favor with solutions to non-performing loan, there are recommendations to the issues also.

Chapter five will generalize main conclusions of the research. The researcher will briefly restate the findings of the papers, including the development of non-performing loans during 2010-2012 and the resolution of non-performing loans in the following years with the management of government. Furthermore, limitations through research and development direction in the future topic will be addressed.

2 LITERATURE REVIEW

2.1 Definitions

It is appropriate to refer concepts and definitions from the previous studies for the basement of the research. The theme of this research is the operation of the banking sector in Vietnam, focusing on the objective of non-performing loans. Hence, the elements of the banking sectors will be introduced and explained in this part.

2.1.1 Financial Asset

"Asset" is the resource that people owns, containing economic values. A financial asset is an asset that allows future benefit in the form of a claim to cash (Pamela Peterson Drake, Frank J. Fabozzi, 2010). Stock, bonds, options are examples of the financial asset. There are creditors who own the financial asset and receive benefits from. Besides, there are debtors, who will exploit benefits from someone's financial assets, and agree to make a payment for that. Accordingly, financial assets can be defined in the relationship between creditors and debtors.

2.1.2 Capital markets

The concept of capital market is an objective of the study on the financial system. The financial system of the economy involves main elements, including capital markets, financial intermediaries, and financial regulations. Accordingly, capital market is the environment that the transactions take place. In capital markets, there are financial intermediaries, serving as facilitating transactions. Banks are intermediaries. Lastly, the regulations are insurance for fair transactions. (Pamela Peterson Drake, Frank J. Fabozzi, 2010)

2.1.3 Banks

Banks are the intermediaries, facilitating transactions in the capital market. Accordingly, banks will account for creating more reliable transactions in the capital market.

Banks will accomplish two main functions, including funding from lenders and creditors, and lending the funds to debtors. (Pamela Peterson Drake, Frank J. Fabozzi, 2010)

2.1.4 Loans, and Performing Loans

The main functions of the banks are to fund and to lend. In other words, funds will be invested or lending as loans. Loans are featured by a criterion, the performing capability. Performing loans are loans that are paid principals and interest timely back to banks. Performing loans ratio is an important criterion for managing an effective bank.

2.1.5 Non-performing loans

Non-performing loans are loans that are in default, or close to being in default (Investopedia.com). Similar to other business areas, capital market contains different types of risk with a certain level. Internationally, people have listed out various types of risk in lending market, in which the most notable is credit risk. "Credit" is the monetary lending relationship in which debtors pay the obligation of principal and interest in the period regarding loan term. The credit risk is the risk of the situation in which debtors are unable to pay either principal or interest, or both.

2.1.6 Non-performing loans provision

Non-performing loans provision is a mechanism over expected losses of non-performing loans. Practically appliance showed that the high ratio of non-performing loans requires the larger amounts of efficient provision. (Hasan and Wall, 2004)

2.1.7 Risks

The lending and investing are special businesses that cannot exclude the nature of risk. The businesses of lending and investing were featured in a wide range of risks, in which several sources of risk have been nominated since its dimensions.

Financial risk is a concept to modify a wide range of risks related to financing. Liquidity risk, funding risk, investment risk, credit risk, etc. belong to the financial risk of the banking sector.

Liquidity risk is the risk that banks do not have enough funds. The situation may be a risk to banks that are responsible for paying lenders and investors the principals and interests. To lenders and investors, if liquidity of banks is not improved, the chances to receive money back will decrease. (CPA Australia, 2009)

Credit risk is the risk that the borrower will default on any debt by failing to make required payments (CPA Australia, 2009). There is also the possibility that the debt is paid over the due day, or partly losses of either the principals or interests, or both. The concept of credit risk is close to the definition of non-performing loan.

Liquidity and credit are the two key attentions of banks in managing. Both liquidity risk and credit risk directly influence banks' activities with significant intensity.

2.1.8 Risk management

Risk management is a management activity, purposing to facilitate a consistent implementation of risks and operating policies (Bessis J., 1999). In the banking sector, credit risk is one of the concerns of risk management.

2.1.9 Asset Management

In the economic downturn, there are plenty of elements becoming troubles. The financial market is a typical factor. The prospect of economic recovery also depends on the performance of financial markets. Hence, it is appropriate to convey that effective asset management is a fundamental element of practice for recovering the economy. Asset management is a process, in which non-performing loans are identified and classified for effective solutions, including selling, recovering, restructuring, and writing off (Woo, 2000).

The selling a non-performing loan facilitates diversification of risk and reallocation of resources (Woo, 2000), in which loans will be sold to a third party to settle down losses.

The recovering non-performing loan is to modify and readjust the loan and its collateral, in which the value of the loan can be recouped through the liquidation of its collateral, or can be sold part of the possession of obligors (Woo, 2000). The effectiveness of this method depends on the perceived value of the loans and other relative assets.

The restructuring of non-performing loan is to reschedule and modify term payment for strengthening the ability of the obligor to repay either the principals or interest, or both (Woo, 2000). The approach may include redefining of term payment, and rescheduling due payment. Successful non-performing loan restructuring may benefit both the parties of the contract.

The writing off of non-performing loans is the removing of loans from the balance sheet, taking losses equivalent to its book value (Woo, 2000). This option is generally conducted when the creditors are coerced to do so, and the cost of maintaining those loans is too high.

2.1.10 Asset Management Company

In many precede Asian financial crisis (Indonesia, Korea, Malaysia, and Thailand), there were key integral parts that helped solving the trouble of non-performing loans, of which the formation of asset management companies (AMCs) is notable. AMCs, public or private, are entities whose main function is to hedge non-performing loans in distressed financial institutions (Woo, 2000). The Asian crisis experienced the expansion of AMCs in many nations.

2.2 Non-Performing Loans in Banking Systems: Cause

Woo (2000) supposed that, on the macroeconomic assumption, non-performing loans are typical signal of the financial crisis. Rising interest rate, economic slowdowns, currency exchange rate depreciation can even severely deteriorate the phenomenon of non-performing loans. During history, high non-performing loan ratio was recorded in Korea, Indonesia, Malaysia, and Thailand in 14, 27, 32, and 51 percent, respectively.

The study of non-performing loans requires a broad range of investigation, including on banking sectors, macroeconomic factors, and political and social features. However, experiences from the financial crisis in many nations, especially in Asia, show that non-performing loan is the product of the problematic issue of financial market. Accordingly, it can be inferred that poor asset quality, limit capital capacity, liquidity shortage,

and poor corporate governance and risk management practices (Harry H.T., and Thuan Nguyen, 2011).

2.3 The need to manage non-performing loans

It is appropriate to restate the importance of non-performing loan management. Non-performing loan management, or credit risk management in the banking sector, is a process of formation and conduction of policies to attain objectives. The objectives of non-performing loans focus on hedging the expansion of non-performing loans, combining with solving current non-performing loans.

2.3.1 The objective for managing non-performing loans

Understanding the causes and consequences of non-performing loans is a crucial prerequisite to tackle non-performing loans phenomenon. Besides, the objective of managing non-performing loans is also a critical element. Woo (2000) has listed out important objectives for managing non-performing loan:

- Facilitation of financial restructuring: a successful management of non-performing loans must aim at restoring liquidity and solvency to financial institutions, restoring confidence and credit rating, and enhancing credit discipline (Woo, 2000).
- High rate of recovery: a high rate of recovery ensures the banks to access news credits; thus, benefits, new borrowers by reducing the risk premium (Woo, 2000).

2.3.2 The needs of managing non-performing loans

Banks are intermediaries in the capital market, functioning to facilitate transactions in the market. Problematic issues in the operation of banks will burden the system; in which non-performing is one of the typical issues (Pamela Peterson Drake, Frank J. Fabozzi, 2010).

3 RESEARCH METHOD

This part of writing will try to explain the method used in research. Basically, different methods of research serve different purposes. This part will also explain the decision on the choice of research methodology, based on the nature and objective of research.

3.1 Choice of Method

Initially, it would be appropriate to mention some of the natures of research. By definition, research is the scientific investigation of the phenomenon, in which individual's speculation is linked with reality (Calmorin et al., 2007, p. 1).

The research aims at discovering facts about non-performing price happening in Vietnam, and analyzing the phenomena with indicators, including causes, consequences, and effects of reform in the banking system lately 2010. Based on the research's objective, the research is characterized by nature of the investigation and analytics. Determining objective of the research helped the researcher decide the appropriate methodology of research. In this paper, qualitative is in order to support the research. Qualitative method is, in fact, is best suitable for investigation and analysis over the whole picture (Kothari, 2004, p. 3). Another aspect in favor of qualitative method is its reliability based on the nature of the topic. The object of non-performing loan, by political reason, does not allow consistency in numerical data, and measurable numbers.

3.2 Research Approach

There are two main elements of the research. Firstly, theories and concepts, regarding the objective, are adopted to strengthen the analysis. Accordingly, comprehensive theories are concrete support for understanding of non-performing loans in Vietnam.

Additionally, the case study is carried to strengthen the argument empirically. The researcher chooses Vietnam as the case because of understanding about the market. The arguments will be inferred from data published by reliable sources, including Asian Development Bank (ADB), Moody, Fitch, the State Bank of Vietnam (SBV), and other unofficial information for news.

Because non-performing loans in Vietnam has begun receiving concern since 2011, this research will analyze the actual features of non-performing loans in 2011. The research will adopt sources of information to indicate tendencies and the development of non-performing loans in the following years.

3.3 Trustworthiness of Qualitative Research

It should be necessary to mention about indicators of qualitative research. Qualitative research is often questioned because reliability and validity are not mutually accepted in research regarding neutralism manner (Shenton, 2003).

3.3.1 Reliability

The reliability assumes that in a similar context, similar participants, similar methods, a similar finding is potentially acquiesced. To maintain a certain level of reliability, the consistency of research method and conduction is a must.

3.3.2 Validity

The validity of the research is characterized by credibility and transferability. Shenton (2003) agrees that credibility describes the congruent between research's finding and reality, while transferability mentions the ability to generalize the finding to other situations.

3.3.3 Limitations

The research is conducted with several difficulties and challenges. The complexity of non-performing loans in nature is the most challenging features. Acknowledged that feature, the researcher attempted to conduct the research with certain of focus on content. Apart from data and results acquiesced from secondary sources, the researcher will limit comment and individual opinion in a reasonable distance.

4 RESULT

In this section, the researcher will try to explain the situation of non-performing loans in Vietnam from 2010 to 2012, added updated newest information in 2013 and 2014. Causes and consequences of the non-performing loans will be discussed. One last aspect in favor of non-performing is the State's asset management company – VAMC. Experts significantly concerned VAMC as effort of the State on handling non-performing loans. Apart from non-performing loans, the overall outlook in the banking industry will be presented, providing background and explanation.

4.1 Vietnam Banking Industry: the Outlook

Vietnam's banking is expected to experience the greatest expansion in Asia for several years from the moment participating in WTO (2007). Over the past two decades, since 1990s, the State has undertaken intensive policies, and concerns to the banking section to increase the national competitive capacity. Most of the policies and reforms were undertaken under the motivation of international agreements and international standards in credit management. There are two main events that highlight opportunities to banking sector. The first one is the agreements and ownership in the banking section during WTO-negotiation. The other one is motivation for reform banking section because of inefficient activities (Anne Ho and R. Ashle Baxter, 2011). The key elements of the widespread reform included the restructuring of the banking section, the opening to foreign investment, the privatizing the state-ownership in the banking section, and increasing and strengthening the capital of Vietnam.

4.1.1 Main tendencies of the Banking Sector during 2006 – 2010

The Vietnamese banking sector has expanded with an amazing number. The total asset of the banking sector doubled from 2007 to 2010, growing from approximately 52 trillion to over 120 trillion VND, according to the State Bank of Vietnam (SBV)'s data. The asset expansion of the banking industry has become more obvious since 2007, with

the presence of many technological appliances in the consumer banking section. The application of credit cards, automatic teller machine (ATM), and e-commerce's were the initial premise for the booming expansion of the banking industry. From zero points in 2008, there were 28.5 million cards published, combining with 11 thousand ATMs operated in 2010. However, despite this impressive number, the whole industry posed a rooming space for growth opportunities in commercial banking services.

The banking sector is divided into four main types, based on ownership features (Figure 1). Briefly, there are six state-owned banks institutions (SOBCs), 37 joint-stock banks and institutions (JSCBs), five joint venture banks and institutions, and five foreign-owned banks and institutions in Vietnam.

State-Owned Commercial Banks (SOCB)	
Bank for Agriculture and Rural Development (Agribank) Mekong Housing Bank (MHB) Vietnam Bank for Social Policies ¹ Bank for Investment and Development (BIDV)	100% Government Owned
Bank for Foreign Trade (Vietcombank) Industrial and Commercial Bank (Vietinbank)	Partially Equitized
Joint Stock Commercial Banks (JSCB)	
37 banks, including: Asia Commercial Bank (ACB) Techcombank Sacombank	
Wholly Foreign-Owned Banks	
HSBC Standard Chartered Bank ANZ Bank Shinhan Bank Hong Leong Bank	
Joint Venture Banks	
(JV Bank Name)	(Vietnamese and Foreign JV Bank Partners)
Indovina Bank	Vietinbank & Cathay United Bank (Taiwan)
VinaSiam Bank	Agribank & Siam Commercial Bank (Thailand)
Shinhanvina Bank	Vietcombank & First Bank Korea (Korea)
VID Public Bank	BIDV & Public Bank (Hong Kong)
Vietnam-Russia JV	BIDV & VTB Bank (Russia)

Figure 1. Vietnamese Banking Sector (Banking Reform in Vietnam, by Asia Focus, Federal Reserve Bank of San Francisco)

The SOBCs have a long relationship with state-owned enterprises (SOEs). Along with the expansion in asset, those SOBCs become closer to traditional banking activities, rather than lending activities with state-owned companies. SOBCs still remained a heavy substitution of lending to state-owned companies, which lead to mutually higher non-performing ratio than other financial institutions. The reason will be discussed later in the following part. SOBCs accounted for approximately 49% of the lending market in 2010 (Figure 2).

Both the public and the private sectors own the JSCBs. The JSBCs have the traditional businesses with small and medium size enterprise (SMEs), and activities of typical retail banks. Exclusive SOBCs, the JSBCs are large sections of the lending market. Combining with insignificant portions captured by foreigner-owned banks and venture banks, they accounted for 51% of the lending market in 2010 (Figure 2).

	2007	2008	2009	2010
SOCB Lending	623	763	982	1221
<i>(SOCB % of total)</i>	58.4%	57.0%	52.5%	49.3%
Joint Stock and Other Bank Lending	444	576	887	1254
<i>(Joint Stock and Other as % of total)</i>	41.6%	43.0%	47.5%	50.7%
Total	1,067	1,339	1,869	2,475

Figure 2: Vietnam Lending Market by Institutions (trillion VND) (Banking Reform in Vietnam, by Asia Focus, Federal Reserve Bank of San Francisco)

4.1.2 The reform of the banking section

Since 1980s, there were primary reforms undertaken by government. The centralization of the reforms was both the privatization and the opening to foreigner investors. Entering into international organizations, and agreements has motivated the openers of recent banking reforms. Notably, the US-Vietnam Bilateral Trade Agreement (BTA) in 2001 during accession to WTO (2007) ended up with significant concessions of the government toward the banking section and financial market. For example, the agreements required Vietnam to allow the participation of 100% U.S. Owned banks into domestic fi-

financial market. The similar requirements will be available to other foreign-owned financial institution when Vietnam finished their accession to the WTO. The opening to foreign banking and financial institutions leads to challenging issues to domestic institutions. As discussed earlier, domestic banking and financial institutions were immature in credit management, lack of information technology (IT) appliances, resulting in weak competitive capacity. Forced to obey amendments from the WTO, and acknowledging the weaknesses of domestic financial institutions, Vietnam ought to hurry up their route to strengthen competitiveness of domestic banking and financial institutions. One of the notable solutions was the privatization in the May 2006 announcement. To boost up the process, the State raised maximum right of foreign ownership in JSOBs to 15% in 2007. There was the State Bank of Vietnam (SBV) will grant a special exception to allow 20% ownership to some selected foreign investors. Another element of the reforms was raising capitals. Stronger capital was a meaningful factor to improve competitiveness of domestic banking and financial institutions. The State has implemented a minimum level required of all the lending institutions in November 2006. In detail, the Act required a minimum USD 140 million in capital in each of lending institutions. During the conduction process until 2010, the State required all banks to submit recapitalization plans for approval. By the end 2010, banks that were unable to meet the requirement will be forced to merge with others, creating larger capitalized banks and institutions. In 2010, the SBV also raised the minimum required capital adequacy ratio to 9%, slightly higher than the Basel framework.

4.1.3 Recent developments affecting banking sectors

The tightening monetary policy has decreased the inflation rate from a very high level. The positive movement of the inflation rate was a favorable condition for efforts to decline interest rate. Besides, other policies, for example, limiting lending to non-production sectors, including real estate, have positive effects to increase liquidity and hedge the expansion of non-performing loans.

Secondly, bank merger and acquisitions in the sectors where another dominant trend. The State has entailed the State Bank of Vietnam (SBV) to impulse mergers and acquisitions of small banks, which was not able to reach adequate capitals and reasonable non-performing loans. The action proposes to increase the consolidation of the whole

system. In January 2012, Eximbank, the largest banks, purchased entire 9,7 % stake of Sacombank from Australian ANZ banks. In the fourth quarter 2012, Vietinbank prepared to sell 20% stake to foreign investment.

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4.1.4 The closing comment

There were optimistic signals from the economy that drive the expectation to prospects of the Vietnam banking system. The economy is expected to continue the expansion due to the enormous market of 90 billion in population. The surge in household incomes is in the next several years. However, the banking system, in particular, and the lending market, in general, is still immature, and unable to support the demand of the market. Hence, there are some features that should be in consideration in favor of the banking industry in Vietnam. Firstly, the booming economy was in trend of expansion, desiring huge amount of capital in the lending markets. Secondly, the economy was featured by struggles with challenging of globalization, especially after participation into the WTO in 2007, resulting in instability in the macroeconomic environment. Lastly, the overheat growth and expansion of the banking system, especially under unflavored conditions of the economy, added poor credit management skills, posed inefficiency in activities of the banking system. One of the indicators proving the weaknesses of the banking system is higher non-performing loan ratio, which is of special attention both domestically and internationally.

In a relative short period, from 2006 to 2010, there was a transform in the banking section, from dominating state-owned system to private ownership. The presence of foreign banks and foreign investors has impulse domestic banks and institutions to improve the competitiveness, in term of either capitalization or management. It would be a shortage to ignore the role of government. The State Bank of Vietnam (SBV) has faced numerous obstacles in an effort to reform and strengthen the banking system. It is still encouraging to believe success in the reform of banks section and the absorption international standard of bank management.

4.2 Non-Performing Loans in Vietnam: classification and the development during 2010 - 2013

4.2.1 Classification

Non-Performing Loans (NP-Ls) is defined in the Decision 493/2005/QĐ-NHNN, and 18/2007/QĐ-NHNN. According to the regulations, Non-Performing Loans (N-PLs) are loans belong to categories 3, 4, and 5 in the classification as below:

- Category 1 (pass assets): Loans, which are still in term, and are able to solely recovery of principal and interest on time. (Quang and Ha, 2005)
- Category 2 (special mention assets): Loans that are overdue less than 90 days, and rescheduled loans that are not due. (Quang and Ha, 2005)
- Category 3 (sub-standard assets): Loans, which are overdue from 90 days to 180 days, and rescheduled loans that are overdue less than 90 days. (Quang and Ha, 2005)
- Category 4 (doubtful assets): Loans, which are overdue from 181 days to 360 days, and rescheduled loans that are overdue from 90 days to 180 days. (Quang and Ha, 2005)
- Category 5 (loss assets): Loans which are overdue more than 360 days, rescheduled loans that are overdue more than 180 days, and debts that are subjects to arrangements directed by Government. (Quang and Ha, 2005)

In qualitative definition, loans can be divided into categories as below:

- Category 1 (pass assets): Loans, which are still in term, and are able to solely recovery of principal and interest on time. (Quang and Ha, 2005)
- Category 2 (special mention assets): Loans that are overdue less than 90 days, and rescheduled loans that are not due. (Quang and Ha, 2005)
- Category 3 (sub-standard assets): Loans, which are overdue from 90 days to 180 days, and rescheduled loans that are overdue less than 90 days. (Quang and Ha, 2005)

- Category 4 (doubtful assets): Loans, which are overdue from 181 days to 360 days, and rescheduled loans that are overdue from 90 days to 180 days. (Quang and Ha, 2005)
- Category 5 (loss assets): Loans that are overdue more than 360 days, rescheduled loans that are overdue more than 180 days, and debts that are subjects to arrangements directed by Government. (Quang and Ha, 2005)

Hence, non-performing loans is classified based on two labels, over 90 dates overdue loans and doubtful capability of payment loans. The classification was very close to IAS frameworks.

However, although the definition of non-performing loans in Vietnam close to international standards, most of the banks and lending institutions recorded non-performing loans based on 90 days overdue loans, but ignoring the analysis of repayment ability. In fact, loans in Vietnam are now classified based on the amount of debt that lacks qualitative as part of the financial position, results of the business operation, etc. Hence, the classification does not reflect the true nature of debt liabilities. Additionally, the banks were abused of encouraging creditors to reschedule the term, which lead to mass decrease of non-performing loans ratio. The action helps banks to avoid the large volume of capital into provision for credit losses, avoid affecting their profits.

As a result, the difference of classification in Vietnam from international standard increases. Hence, the difference of measurement about non-performing loan ratios between domestic and abroad institutions is due to approaches and appliances. Practically, the inconsistent data significantly challenged to analyze about non-performing loans and its effects. Understanding that point is one of the key basement to analyze of non-performing loans in Vietnam. The bias of measurement the phenomenon of non-performing loans will be discussed in the following chapter “Actual value of N-PL during 2010-2013).

4.2.2 The economy in 2011-2013, and prospect for 2014-2015

After two decades opening and attaining reforms, the economy has experienced promising growth, an average of 7.3% during 2001 - 2010. However, the economy showed inherited weaknesses. The non-performing loan ratios boosted up during 2011 - 2013, es-

pecially in the real estate market. The phenomenon directly deteriorated the stability of capital markets. At the time, the global economy also experienced inconvenience condition. From these points of view, the State has issued the Decree 11, emphasizing on controlling the inflation, and stabilizing the macro economy.

During 2011 - 2013, the inflation rate decreased from 18.13% to 6.04%, in 2011 and 2013, respectively (Figure 3). The figure below shows that the State, by undertaking wide ranges of policies has been successful in maintaining the inflation rate around 6% since 2013. Comparing to other developing country, Vietnam showed an average 6% increase, which is an ideal condition for maintaining growth, ensuring the stability of the macroeconomic. Too low inflation rate, in fact, can be an indicator of a deflating economy, in which the investment activities and expansion of the economy would be challenged. Besides, maintain a favor inflation rate at below 5% in the first half of 2014 is an important element in efforts to lower the nominal interest rate.

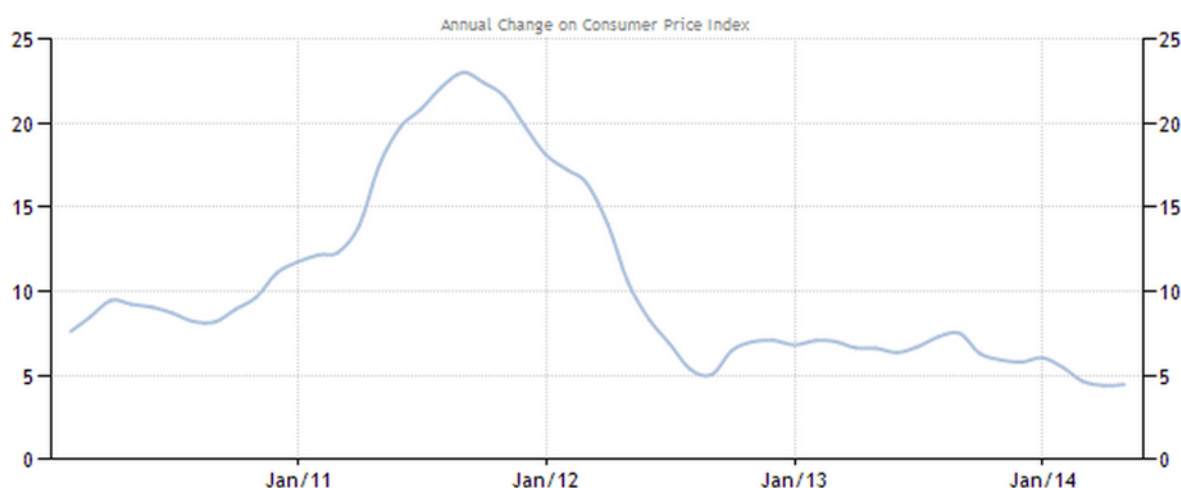


Figure 3: Vietnam Inflation Rate (Tradingeconomics.com, General Statistic Office of Vietnam)

The interest rate declined from approximately 15% in 2011-2012 to around 7% since the latter half of 2013 (Figure 4). The decline of interest rates has facilitated investment activities and expansion of manufacture. The improvement of macroeconomic conditions has a direct effect on the recovery of the economy, in which the receiver of capital market was a significant attribute. Hence, the recovery of manufacturing activities was

an essential point when analyze the development and resolution of non-performing loans during 2011-2013.



Figure 4: Vietnam Interest Rate (Tradingeconomics.com, General Statistic Office of Vietnam)

The GDP's increase was around 5.6% during 2011-2013. Comparing to the average 5,1% of ASEAN (IMF), the increase in GDP of Vietnam still slightly higher.

Since the simultaneous conduction of monetary expansion and narrow fiscal policies, the interest and inflation rate experience the similar downturn during 2012 to 2014 (Figure 3 and Figure 4). The state has terminated significant portion of government spending on infrastructure constructions, resulting in a decrease of the money supply. Consequently, the inflation rate was managed at 5% since 2012. Simultaneously, the National Bank of Vietnam conducted various monetary policies, including decreasing the interest rate, discontinuing devaluation of money. The actions resulted in the decrease of interest rates, which had a meaningful effect to recover manufacturing. The economy showed the recovery of GDP growth since the later half of 2013 (figure 5).

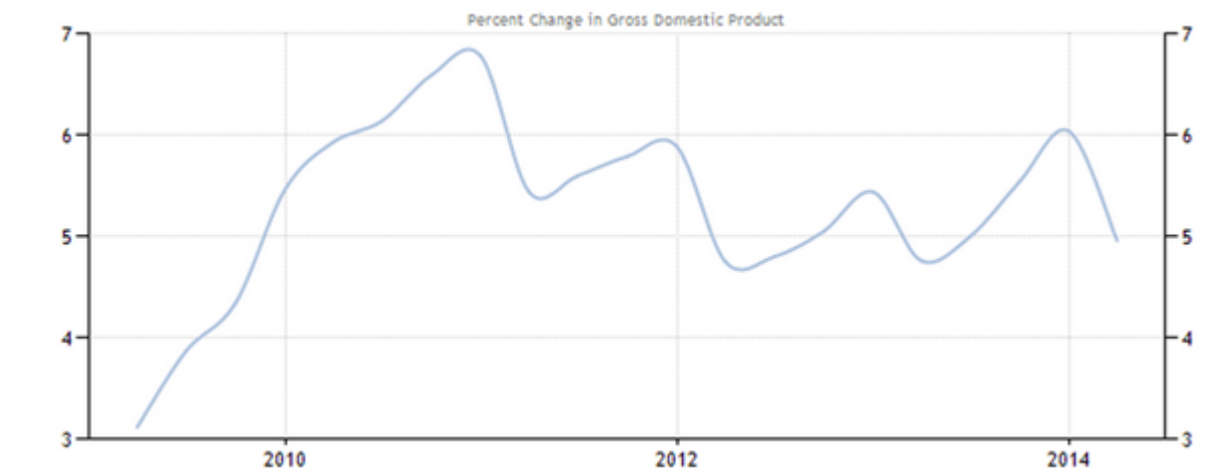


Figure 5: Vietnamese GDP (Tradingeconomics.com, General Statistic Office of Vietnam)

The trend of GDP, interest rate, and inflation rate are graphed below (Figure 6). The graph showed that the State has simultaneously conducted policies to alleviate extremely high inflation and interest rate since 2011. Consequently, the economy experienced devaluation in the year 2012. The stability in policy, aiming at decreasing inflation and interest rate, in the year 2013, and 2014 has gradually improved macroeconomic conditions. The economy slightly went up during 2013-2014, showing prospects for recovery in the following years.

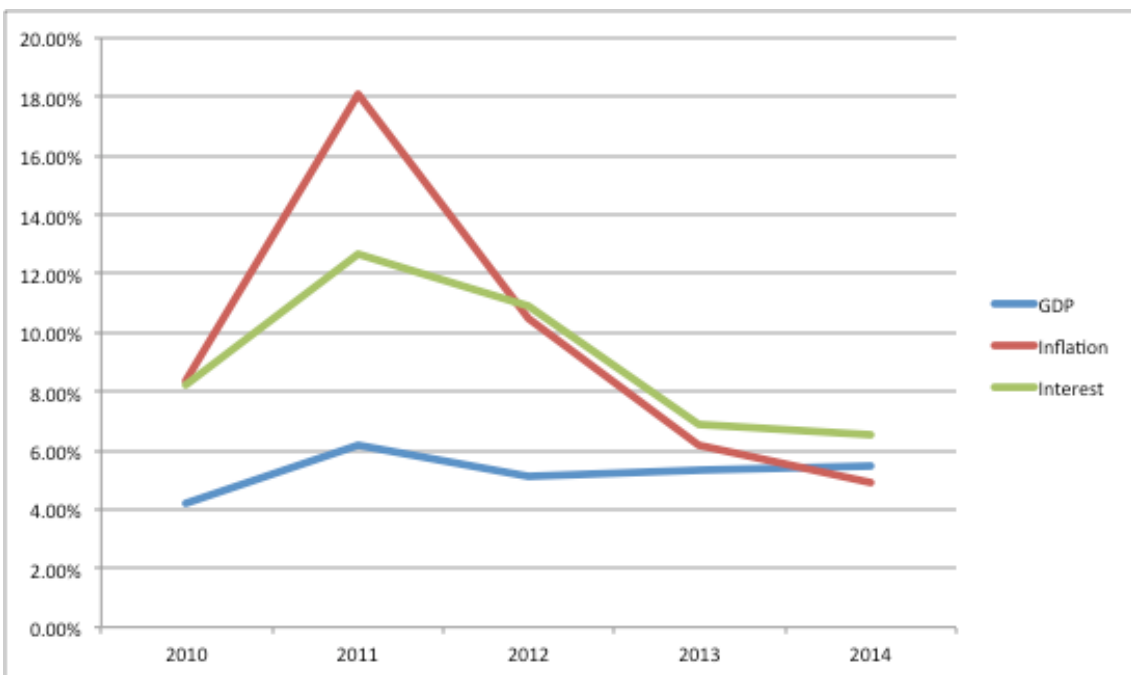


Figure 6: The macroeconomic factors (summary from difference sources)

For the prospects of the economy in 2014-2015, there are concerns to stabilize the macroeconomic conditions, restructure the economy to create new impulsion for the economic growth. The State has claimed, in the report of the strategy for the economy development, to reach USD 3000 for the GDP per capita by 2020. By some measurements, the target growth of the economy should be around 8%, in the coming years, to attain the target. Thus, the top priority concern of the State in the coming years would be improving the macroeconomic conditions, in which the capital market is the key concern.

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It can be deferred that the tightening fiscal policies will not last long; especially considering that the economy is now in the heating growth, and the demand for infrastructure is in distress. During the coming year, the government has to responsible for huge spending on infrastructure and social welfare. Hence, the monetary policies will be the ultimate tools for managing the macroeconomic conditions. Acknowledging that point, the researcher supposed that the economy would recover since 2014, notwithstanding the poor performance of the economy in 2013.

4.2.3 The actual development of N-PL during 2010 - 2013

According to State Bank of Vietnam, non-performing loans ratio in 2011 was around 3.2%, in which 60% of non-performing loans was allocated to state-owned enterprises (SOEs). However, the non-performing loans ratio was calculated based on Vietnamese

Accounting Standard (VAS), which excluded overdue loans. The IMF estimated NPL ratio would be over 10% under the IFRS (IMF, 2012). In 2013, it was still inconsistent about NPL ratio. Individual banks reported below 5% non-performing loan ratio at the end of 2012, while the SBV estimate this number around 6% in several months later. International institutions kept pessimistic opinions about non-performing loan ratio, in which Moody estimated that non-performing loans ratio was not lower than 15% in 2013. Fitch supposed the number should be 12% in October 2012. In a comparison, it can be deduced that non-performing loan ratio, estimated by Fitch, in October 2012 was almost triple that of the SBV (Figure 7).

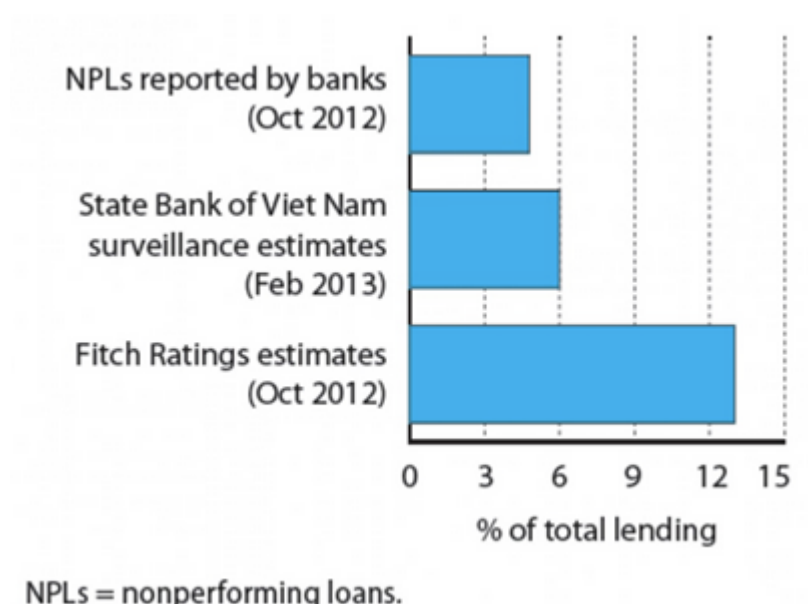


Figure 7 Different estimations of non-performing loans in Vietnam (Banking Reforms)

The different opinion about the value of non-performing loans between the State Banks of Vietnam and international institution was the consequences of approaches in the measurement. Although the State Bank of Vietnam has issued the classification for non-performing loans, including quality and quantity basement, many banks conducted only the quantity basis for measurement of non-performing loans. The quality basic requires banks to evaluate the creditors' financial position, results of the business operation, etc. Hence, the classification does not reflect the true nature of debt liabilities. Because international institution did not formally published measurement about non-performing

loans in Vietnam, the measurement of SBV will be acquiesced for analyze of non-performing trend in 2011-2013.

In 2011, the State initially published estimation of non-performing loans ratio at around 3,06% (Figure 8), in the end 2011.



Figure 8 Non-performing loans in Vietnam, 2011 (The State Bank of Vietnam)

In 2012, non-performing loans ratio increased gradually during the whole year, almost peaking roughly 5%. The non-performing ratio dropped significantly in December, closing at approximately 4% at the end of the year. (Figure 9)

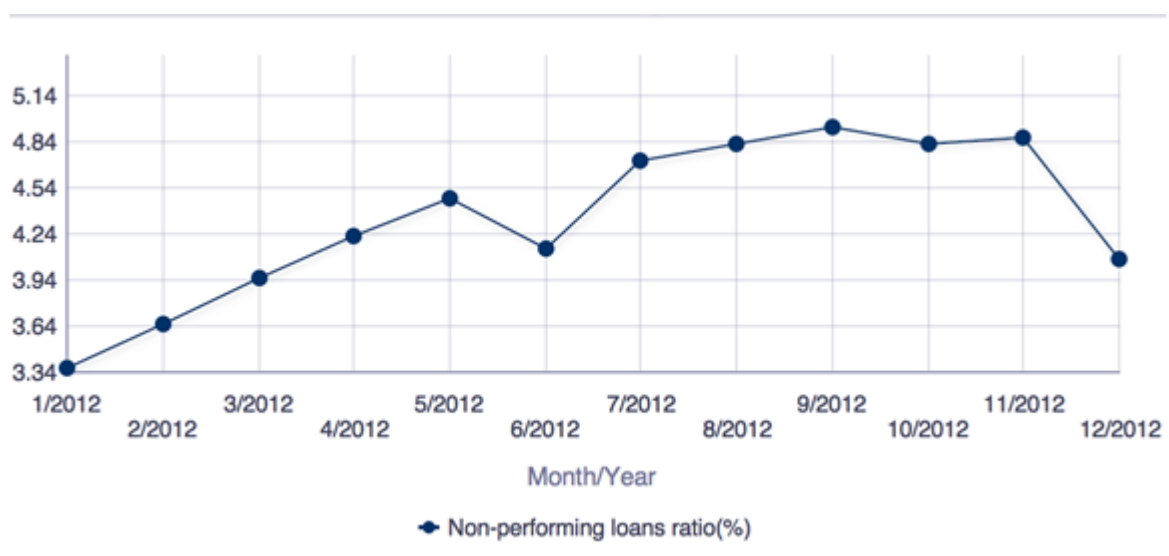


Figure 9 Non-performing loans in Vietnam, 2012 (The State Bank of Vietnam)

In 2013, the non-performing ratio was under the control and remained a stable trend almost of the year. The ratio dropped significantly in December to 3,6% (Figure 10). Considering the formation and purchasing non-performing loans of the VAMC, the sudden drop of non-performing loans ratio in the ending months was understandable.

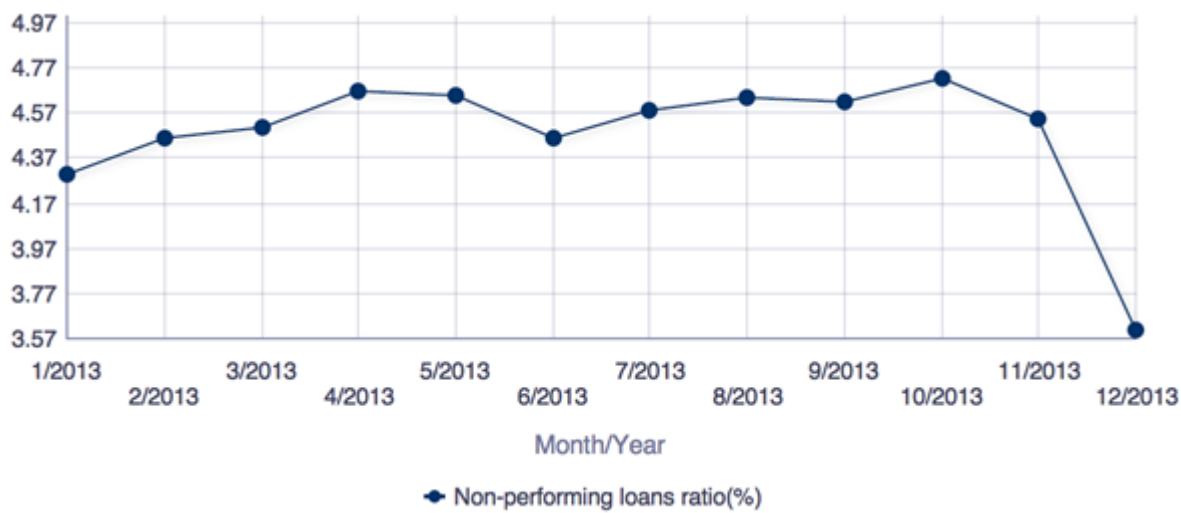


Figure 10 Non-performing loans in Vietnam, 2012 (The State Bank of Vietnam)

Hence, along with target to pull down non-performing loans ratio to 3% of the SBV, it can be inferred that non-performing loans will be in a downturn in the whole year 2014, and 2015. However, the absorption of non-performing loans in the whole sector was mostly the consequences of the formation of VAMC, which will be explained in the latter part.

4.3 Non-Performing Loans in Vietnam: Causes

It would be necessary to recall that the country has experienced a long period of macro-economic instability, resulting from the surge in growth, high inflation rate, and inefficiency in the State economy sections. Hence, the credit crunch in 2010 can be explained as a consequence, following accumulation of macroeconomic troubles. Following the participation in the World Trade Organization (WTO) in 2007, positive signals on the economy and optimistic about economic development drove the economic bubbles. Apart from demand of capital, increase in foreign capital inflow accelerated the growth in domestic credit, at approximately 280% during 2007-2011 (Table 1). A surge in do-

mestic credit was followed by a substantial rise in inflation. The low growth of the gross domestic product under the potential rate depressed the confidence on capital market.

Table 1 Credit growth in Vietnam

MONEY AND BANKING (billion Dong)	2007	2008	2009	2010	2011
Money supply (M1)	443429	442984	581535	640959	705998
Currency in circulation	220514	236848	293225	337949	370992
Demand deposits ⁱ	222915	206136	288310	303010	335006
Quasi-money ^j	904814	1179145	1510912	2148226	2491962
Money supply (M2)	1348244	1622130	2092447	2789184	3125961
Foreign assets (net)	410414	428929	312264	266567	300046
Domestic credit	1096780	1400693	2039686	2689527	3062549
Claims on government sector	29051	61430	170431	213991	232356
Claims on private sector ^k	1067729	1339263	1869255	2475535	2830193
Claims on other financial institutions ^l					
Other items (net)	-158950	-207492	-259503	-166909	-236634
Money supply (M2) annual change, percent	46.1	20.3	29.0	33.3	12.1
M2 percent of GDP at current market prices	117.9	109.2	126.2	140.8	123.3

Source: Asian Development Bank (ADB)

When observing the non-performing circumstance in Vietnam, researcher treats the object as part of the big picture, the economy. There are elements that characterize the nature of the credit crunch in Vietnam, and also are mutually affected by the credit crunch.

These elements will be explained as economic factors, which will, directly or indirectly, affect the circumstance of non-performing loans.

4.3.1 Limits in capital capacity

Supply was not able to mitigate the demand for capital in a period of economic booming 2007-2010. The pressure of lacking supply of capital has impulse the surge in interest rate. The interest rate went up to 13.4% in 2008 and remained over 10% following years (Table 2). The stability of high-interest rate over a long period worsens the economy.

Table 2 Interest Rates in Vietnam

<i>Interest Rates</i> percent per annum; period averages	2007	2008	2009	2010	2011
Savings	3.06	3.68	2.85	3.00	3.20
Time: 6 months	8.19	13.34	10.15	11.14	13.60
12 months ^m	8.80	13.46	10.37	11.50	13.00

Source: Asian Development Bank (ADB)

The overheated growth of the banking section, combining with pressure from capital activity, resulted in urgent demand for raising and funding capital. At that time, the banks in-creased eagerly deposit interest rate, boosting the increase of the lending interest rate. The creditors, mostly be the enterprises, faced increasing difficulty, the extremely high cost of capital. Many of business enterprise went bankrupted or temporarily closed down their businesses, resulting increasing contributions to non-performing loans. After all, the pressure from regulation about capital capability has boosted the process of in-crease asset and capital. Banks involved in the race of raising capital and increasing credit growth. Consequently, banks eased standard of credit approvals in order to maintain the efficient return. This fact was the reason for non-performing loans.

The limit in capital capacity was expressed by the extremely high cost of raising and funding capital, approximately 11% deposit interest rate in 2010 (Table 3). This 11% deposit interest rate resulted in 17% lending interest rate in 2011 (Table 3). Actually, none of the businesses could survive at that level cost of capital. Hence, many SMEs went bankrupt, leading to credit constrained to the whole banking system. The detail of this fact will be discussed in the following part.

4.3.2 The fragmentation of the market

The banking sector is characterized by extremely high fragmentation of the market. The whole market was worth about twenty billion dollars, involving the presences of hundred banks and institutions (Table 3). The fragmentation of the capital market has challenged the activities of the capital market. Firstly, the lack of liquidity may arise, resulting the inefficiency of the whole sector. The shortage in size also a challenge to development of banks.

Additionally, the cross-ownership issue is a challenging to the activities of control and manages interbank transactions.

Table 3 Characteristics of banking sector in Vietnam

Interest Rates percent per annum; period averages	2007	2008	2009	2010	2011
Deposit interest rate (%)	7.5	12.7	7.9	11.2	
Lending interest rate (%)	11.2	15.8	10.1	13.1	17
Credit market share by state-owned banks	57.1	55.7	54.1	49.3	
Number of banks	85	94	94	101	
Credit growth (%)	53.9	25.4	39.6	32.4	10.9

Source: World Bank (WB)

4.3.3 The irrational allocation of loans

The economy experienced overheated growth in a long time, characterized as unsustainable, including inflation and other difficulties. Responding to depressed signals on the economy, the State issued monetary and fiscal policies in an attempt to slow down the inflation rate. One of the actions was the cutoff of money, purposing to hedge the credit growth to less than 20%. The result of those actions was the cutoff of banks system on easy term lending. The real estate and stock market were initially maltreated, illustration by lowering the value of assets, and freezing all of the activities. Many projects in the real estate market were stopped, while the stock market was hampered by the withdrawal of a foreign investor when the economy slows down.

Unfortunately, the banking system contained other challenges, the irrational allocation of credit. For a long time, the capital flowed into most dominating markets, real estate and stock markets. In 2011, real estate market accounted for 11.96% of total credit market (SBV, 2011). The State Bank of Vietnam also estimated 10.3% of total non-performing loans were substituted by real estate market. Along with real estate, the stock market was not also encouraged for credit approvals. Actually, the State Bank of Vietnam had restricted proportion of credit approval for stock market and non-manufacturing market under 16% of the total value of the credit market. The State Bank of Vietnam (SBV) requires that banks, which had non-performing loans ratio under 3%, were allowed to approve credit for the stock market. From the regulation, it could be deduced that credit approvals for stock market should be insignificant, since most of the banks were maintain approximate 4% non-performing loans ratio. Yet, the actual amount of credit approvals for stock market accounted for 6.5% total value of the lending market (SBV, 2011). Hence, real estate market, combining with the stock market, accounted for approximately 18.5% of total credit approvals. Another indicator was credited to non-manufacturing markets, of which 14.7% of the total market flowed into those markets in 2011 (SBV, 2011). Basically, credit approvals for real estate and the stock market were not encouraged (SBV, 2012). However, restriction in fiscal and monetary policies published in late 2011, the stock market and the real estate market initially hampered. The breeze of those markets significantly deteriorated non-performing loans phenomenon.

Another indicator of irrational allocation of credit is that constantly half of the credit on the market was held by state-owned enterprises (SOEs). During the time, losses in business activity of SOEs were blamed for increasing pressure on non-performing loans. However, actual non-performing loans ratio of this section was not calculated and mentioned concisely by SBV. Many researchers and institutions agreed that non-performing loans were mainly allocated into credit to state-owned enterprise (SOEs). Moreover, in a report to Standing Committee of National Assembly in 2011, the State Bank of Vietnam (SBV) estimated that about 70% of non-performing loans was substituted by state-owned enterprises (SOEs), of which 53% belonged to 12 largest SOEs. Because of the relationship with state-owned enterprises, non-performing ratios in six states-own commercial banks (SOCBs) were notified at around 5%, when the rest of the banking sector reported approximately 3% non-performing loans. Thus, it can be concluded that state-owned enterprises are the major resource of non-performing loans in the market.

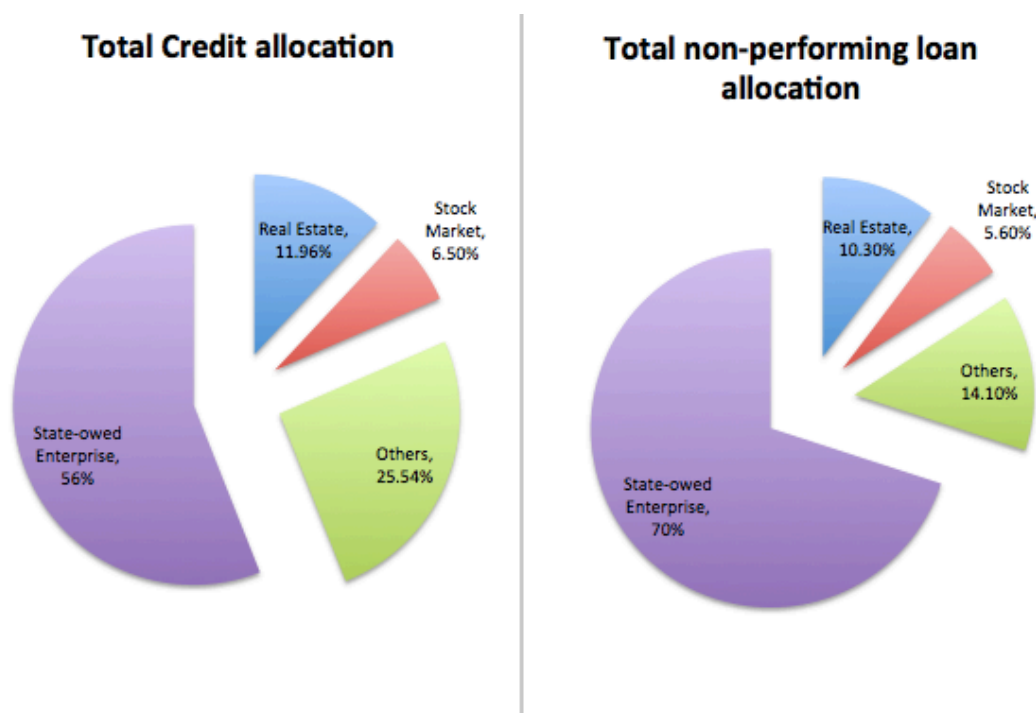


Figure 11: The allocation of Loans and Non-performing loans in 2011

Excluding the portion of state-owned loans, it can be seen that credit approval on real estate and stock market accounted for a third of total remaining loans (Figure 11). However, also excluding non-performing loans of state-owned enterprise, real estate and

stock market, together substituted for over half of the rest non-performing loans in the market (Figure 11). Hence, it is extremely importance to refrained non-performing loans of real estate and stock market for expansion. In fact, because the stagnation of the economy, the absorption of non-performing loans in the real estate and the stock market was feasible in a limitation. However, the disposition of non-performing loans from state-owned enterprise was years taking time, thanks to restructuring loans after privatization of those enterprises. Additionally, non-performing loans, belonging to state-owned enterprise, play an important role in serving State's policies. Thus, it is infeasible to dispose of non-performing loans of SOEs.

4.3.4 Poor liquidity on the whole sector

It is appropriate to conclude that the liquidity of the whole system dried up. The deposit interest rate maintained at too high levels for a long time (Table 3). Banks were willing to pay the high cost for funding the capital in the short run, even tend to pay at all cost to handle the shortage of liquidity. Additionally, the high interest of the interbank market is another indicator. There is no formal report for this number, but many experts agreed that the inter-bank interest once came up to 20% in 2011 (Harry H.T., and Thuan Nguyen, 2011).

4.3.5 The closing comment

In conclusion, researcher supposed that limited capital capacity and inefficient risk management were direct foundations of non-performing loans at commercial banks, in particular, and the banking sector, in general. Besides, the collapse of important market, which comprised a huge amount of credit allocation, was the implicit cause of non-performing loans. However, to fully address the cause of non-performing loans, it would be the shortage to ignore the role of government, specifically the State Bank of Vietnam. The State Bank of Vietnam was blamed for the shortage in controlling the issue.

Addressing the causes of non-performing loans would be an important fundamental to analyze and solve the problem.

4.4 Non-performing loans in Vietnam: Consequences and tendencies

4.4.1 The effect on banks

The increase of non-performing loans ratio, and its remaining above 3% could significantly influence the banks (SBV, 2011). The regulation required a sufficient amount of provisioning, equivalent with non-performing loans ratio. It can be inferred that higher non-performing loans mean a larger amount of the provision on balance sheets, which directly increased cost of capital of the banks. Actually, the provision of a sufficient level was a challenge for banks, especially in the effort of decreasing the lending interest rate to support and stabilize the macroeconomic.

Additionally, non-performing loans ratio remained at high level, three to four times the average ratio of the global, was a challenge to efforts to maintain confidence of credit rating. Banks, with high non-performing loans ratio, might cause panic to investor, customers, and staffs. In the case banks had to devalue and cut loss on non-performing loans, banks would be suffered by losses in the balance sheets, directly harm operational activities and growths.

4.4.2 The effect on the economy

The stability of high non-performing ratio influenced the economy in a widespread area. Non-performing will directly hamper operational activities of banks and the growth of the economy. Non-performing loans will limit the capability of the banking sector over the demand of capital from the market. Non-performing loans that arise from losses of manufacturing and commerce will result in the stagnation of capital. The production will stagnate under the domino effects. In face, non-performing loans, at some moment, substituted for approximate 9% of capital market, resulting in the shortage of the money supply, and the instability of the banking sector.

After all, high non-performing loans ratio leads to threats of losing liquidity in the banking sector. Because of the complex relationships between domestic and foreign markets and inter-bank markets, dangerous situation of non-performing loans in a specific bank is troublesome to the whole sector. Hence, too high non-performing loans ratio will influence to the health of the economy in widespread areas.

4.4.3 The needs to solve N-PLs in lending market

It is reasonable to comment that credit growth is the most important criteria and concern of banks in Vietnam, especially when a deadline for capital restructuring required by the State Bank of Vietnam was coming. The pressure to submit USD 140 million for efficient capital capability coerced banks in a race to develop credit activities, despite the threats from overheat credit growth. During the most dynamic growth of the banking sector, banks aggressively developed credit growth by lowering standard for credit approval and credit appraisals. If loans, which cannot collect either interest or principals, remain at a high level, the stability and activities of banks will be under threats. Unfortunately, at many moments, banks faced troublesome loans relates to real estate credits, resulting the stagnant in the whole system. Moreover, the embarrassment of banks in controlling and maintaining the stability of the system showed poor experiences in management. Basically, banking sector in Vietnam lacked in both management experience and efficient capital capability. Thus, the needs to narrow down non-performing loans ratio in a reasonable limit became necessary.

In any financial crisis, commercial banks get into common problems, including poor asset quality, limit capital capacity, liquidity shortage, and poor corporate governance and risk management practices (Harry H.T., and Thuan Nguyen, 2011). Unfortunately, those problems were almost presented in Vietnam. From this analyze, Vietnam would have faced a crisis, unless the State urgently reacted to the phenomenon.

4.5 Experiences from management of non-performing loans in different nations

4.5.1 The United State, the real estate crisis

Non-performing loans in real estate market was one of the main reasons of the US crisis during 1989 – 1994 (FIDC, 1997). Intensive volatility exchange rates, inflations, and deregulation in banking sectors created unstable phenomenon in banking sector's activities. Banks, at that time, approved real estate loans riskily and aggressively, due to the pressure of competition. Loan approvals for real estate substituted for 18% to 27% of total value loans in the whole sector in 1980 and 1990, respectively (FIDC, 1997). In 1980s, the real estate market experienced booming expansion due to the tax incentive gave to real estate investment (FIDC, 1997). Banks were aggressively competing each other for that opportunity. The development of loan approvals for real estate, combining with high risk of real estate asset, was the main reason for exceeding demand and the dilutive value of the real estate market. The burst of real estate burble cause a devaluation of real estate market, resulting in deteriorating of collateral of loans and mortgage assets. Thus, the real estate market crisis was a significant portion of the loan default in 1989 – 1994. The situation became worst, boosted by the overly aggressive real estate's loan approvals, and by the adverse economic conditions (Curry, Timothy, and Shibus Lynn, 2002).

There were firm reactions to solve the issue. Approximate 1,600 banks were encouraged for restructuring, either by recapitalization from the Federal Deposit Insurance Corporation (FDIC), or by coercively closed during 1980 – 1994. The Revolution Trust Corporation (RTC) established in 1989 as a federal agency, functioning to accelerate the preservation and disposition of housing. Approximate USD 705 billion was transferred to FIDC, and RTC to solve the issue. In the ending year of the crisis, about USD 305 billion in assets was sold for cash recovery. The rest USD 400 billion in asset was disposed of by variety of transactions, including the auctions, securitizations, equity partnerships, etc. (FIDC, 1998).

The development of non-performing loans in the United States repeated in Vietnam, particularly in the portion of the real estate market. In a comparison, loan approval for real estate in the United States was 18% (1999), while this number in Vietnam was 11% (2011).

In fact, the American has spent a sufficient amount of capital to accelerate the disposition of non-performing loans, and solve the solvency concern of the system. However, this situation will not repeat in Vietnam. Firstly, the State Bank of Vietnam has issued a bunch of policies to decrease the inflation rate, including tightening fiscal policies. Secondly, real estate, an extremely productive, combining with a huge amount of the national saving hold by consumers, will not be the priority of government spending for rescuing the capital market. In fact, in the initial phase of NPLs' resolution process in 2011, the State Bank of Vietnam has entailed VAMC to refrain from purchasing non-performing loans on real estate. However, the State issued a fund in 2013, worth USD 1.5 billion, for amortizing loans, as a support to rescue the real estate market.

4.5.2 China

The concern of non-performing loans in China has risen since 1999. Considering the lending relationship in which credit approvals based on the intervene of the state, rather than credit proper, due diligence, or standardized conditions. In the ending years of the 1990s, China experienced a transition to a market economy. Since the lacking professional of loans disposition and risk management in loans approval, the economy experienced shocks and financial losses (Peiser, and Wang, 2002). There was an estimation of USD 500 billion of non-performing loans and distress debt in 2002. The four main state-owned banks substituted for USD 226 billion, equivalent to 26% non-performing ratios (Ernst & Young, 2003).

The state has issued a resolution of distressed loans by established four asset management companies in 1999. Until the ending 2003, state-owned banks transferred USD 168 billion to asset management companies, which dominantly in charge of the management of non-performing loans (Ernst & Young, 2006).

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
NPL	20.4	13.2	8.6	7.1	6.2	2.4	1.6	1.1	1.0	0.9

Figure 12: The non-performing loans ratio in China source: The World Bank data 2013 (<http://data.worldbank.org/indicator/fb.ast.nPer.Zs>)

In the following years, the China separated the state loans from commercial loans, which directly handle the pressure of public debt. Until 2005, China has recovered approximately 40% the amount of non-performing loans since 1999. Until 2010, non-performing loans was mostly removed from banks' balance sheet (Figure 12).

The main four state-owned banks in China were dominantly in charge of managing their non-performing loan volume, in which there was a decrease on the government's intervention. The banks began to adopt new loan classification, evaluation, and independent credit approval. The change in policy has reshaped credit management activities of the banking sector (Economic Policy Research Center (EPRC), 2010). Besides, to recapitalize the four state-owned banks and accelerate the privatization reform, the government has injected the capital of those banks to triple by state resources. After all, four asset management companies were established to accelerate non-performing loans disposition, in which debt-equity swap was the method for funding the asset management companies. Proactively, banks and asset management companies will sell non-performing loans to private investors, including foreign investors, securitizing loans, etc. Consequently, the quality of asset in the four main state banks was significantly improved, and soon after issued a public offering. However, these non-performing loans were not solely erased from the capital system, but transferred from state-owned banks to other institutions, such as asset management companies. Hence, the threats of non-performing loans to the capital market still viable.

The case of Chinese capital market since 1999 is a very close example to Vietnam, presently. It is significant to note that the phenomenon in China, as well as that in Vietnam, was a credit distress. Additionally, the destructive effect of non-performing loans on the economy was not viable. Review the timeline for the resolution of non-performing loans in Vietnam, it might conclude that there are several actions were repeated which happened in China, especially the recapitalizing of banks through an asset management company. It is doubtful to conclude that non-performing loans in Vietnam will be treated impetuously as the China did. The following of government should be observed watchfully to decipher the determination of solving non-performing loans.

The fact was that non-performing loans acted as a catalyst to accelerate the reform and restructuring of capital markets in Vietnam and China. However, the experiences of other nations, which were very different, are also very valuable.

4.5.3 Japan

Japan was the largest non-performing market in Asia in 2002 (Ernst & Young, 2001, p. 2), equivalent to USD 1,200 billion. The Japanese market was characterised by strong gearing, including debt over GDP ratio of 146% (Ernst & Young, 2001, p. 2). Leverage was also extremely high in the real estate market, particularly in the bubble burst in 1980s (Rico Rottke, 2009). The economic slowdown attacked the real estate market, resulting in the decrease of value tremendously. Borrowers defaulted, leading to huge financial losses in the whole sector. In 1999, the Resolution and Collection Corporation (RCC) was established for boosting up the recovery and resolution of non-performing loans (Callen, and Ostry, 2003). Until the end 2004, approximate 13% of all non-performing was restructured by RCC. The rest 87% account for acquisition and resolution by investment banks and funds (Ernst & Young, 2004, p. 23).

Hence, the resolution of non-performing loans in Japan was also significantly attributed with a type of asset management company. Vietnam has received advice from Japanese about the mechanism for recapitalizing non-performing loans in financial institutions. Actually, Vietnamese received valuable consultancy from a Japanese firm to construct a legal framework for VAMC.

4.5.4 Germany

The concern of non-performing loans has risen since 1990s, as part of the “dot-com bubble” wave. The Germans have successfully developed a mature market for non-performing loans before the global crisis 2003 – 2007. Presently, Germany has sufficient infrastructure to handle non-performing loans in the capital market, including advisors, service network, and legal framework. However, banks and financial institutions showed their reluctance in selling non-performing loans to third parties. The anxious and doubtful forecast to the prospectus of Eurozone economy was the main reasons. Additionally, banks have to deleverage its capital structure for the requirement of Basel

III, which encouraged banks to maintain non-performing loans in the asset account until investors evaluate reasonable evaluation to those non-performing loans. From informal estimation, non-performing loans in Germany was above EUR 200 billion in 2009, yet the issue did not significantly improved during 2010 and 2011 (Figure 13).

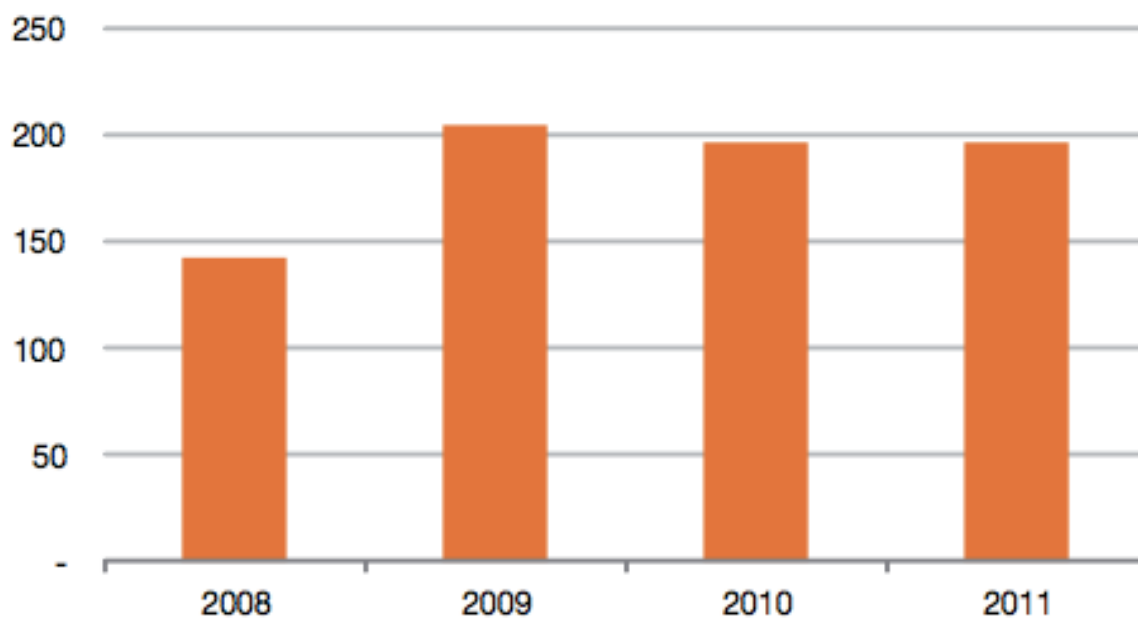


Figure 13: Non-Performing loans in Germany (Source: A growing non-core asset market European outlook for non core and non performing loan portfolio)

Hence, Germans banks had to refrain from selling non-performing loans while actively solving internal issue, including improving capital ratios, restructuring and erasing un-qualified assets, and restoring profitability. Many banks had their internal audit department, taking charge of solving non-performing loans. Hence, it can be deferred that non-performing loans were solved actively by commercial banks in Germany and other European nations. In other words, the European Bank did not play a vital role in recapitalized the capital market. Instead, they enforced the resolution of the system by issuing extremely strict requirement in Basel II, and lately updated to Basel III.

Vietnamese also repeated similar challenges in an effort to accelerate the resolution of non-performing loans. Banks, in Vietnam, was reluctant to sell non-performing loans to VAMC partially because the pressure from shareholders. The market of capital in Vi-

etnam was extremely low on transparency. Banks intended to hide the burden of non-performing loans in the balance sheet. Hence, despite starting from different behaviors, commercial banks in Vietnam and Germany have initially been reluctant to receive recapitalization from government.

However, the State Bank of Vietnam supposed that commercial banks, solely relying on themselves, were not able to tackle non-performing loans internally, but even to delay the government's determination to solve non-performing loans. If the situation above had happened, the effect of delaying the determination of solving non-performing loans would have seriously attacked the efforts of government. In the worst case, loss in the asset, combined with pressure maintaining profitability, forced banks to seek higher profit in commercial activities. High-interest rate may harm the macroeconomic policy. The State Bank of Vietnam roughly coerced banks to collaborate with government in solving non-performing loans by requirement of capital ratio, debt provision ratio at high level. In other actions, unqualified banks were forced to merge, or to be taken over.

4.5.5 ASEAN nations

ASEAN is the association of Southeast Asian nations. The 1997 financial crisis in Asia destructed the capital market in several nations, including Thailand, Malaysia, and Indonesia. Generally, the resolution of non-performing loans in those countries relied on restructuring under quality loans and recapitalizing lost on the market. For both the occasions, asset management companies were dominantly applied in those nations. There were two main classifications of asset management company formations, the dispersion and concentration participation of asset management companies.

In Thailand, the disposition non-performing loans included the participations of both state-owned AMC (supported by the Fund for the Development of Financial Institutions - FIDF) and the privately owned. In contrast, the concentration periods of AMC have begun since the establishment of the Asset Management Company of Thailand (Thai Asset Management Corporation - TAMC) in 2001. For the dispersion activities of AMC, the effects of disposing of non-performing loans was not significant because the non-performing loans were not excluded from the balance sheet of the banks. Banks still had to maintain an adequate capital ratio, and provisioning ratio for both the asset man-

agement companies, and the banks themselves. Hence, the approach was counterproductive, increasing the pressure of maintaining the greater amount of the asset over credit approval. In contrast, the model of concentration activities, with the running of only one AMC – TAMC (the Asset Management Companies of Thailand), was effectively solving the issue. Firstly, one dominating asset management company, with the empowered by the government, refrained from the problematic concern of legal and regulatory. Secondly, the formation and activities of TAMC did have a significant effect on disposition non-performing loans, in which, non-performing loans were removed from the balance sheets of banks.

Vietnamese has adopted experience about the development of asset management companies in those countries when formulating the VAMC. The urgency in the desire to disposition non-performing loans has enforces the state to constructed a concentration model for the activities of asset management companies.

4.6 Vietnam's Plans for Managing NPLs and Banking System Reform

It can be monitored that the two key solutions, undertaken by the State for the non-performing management, we're debt recapitalizing and debts restructuring. Debts recapitalizing includes urgent solutions and capital recovery, undertaking efforts in loans, collections, collateral preclude, and loan sales to asset management companies (AMCs). In contrast, debt restructuring approaches non-performing loans through modifying standard for loan approvals, which is relatively slower in impact. (Wan Qun, 2006)

Many researchers have discussed the positive and negative consequences of both the solutions above. In this section, researcher will explain solutions taken in Vietnam. For several reasons, the stability of economic in Vietnam cannot support for urgent approaches. Firstly, people protested again paying taxes for the losses of the banking sectors. Secondly, the State was conducting restricted fiscal and monetary policies. Consequently, money was not pumped out to absorb fully non-performing loans. Finally, the volume of non-performing in the whole sector exceeded the capacity of the government.

The latest updated non-performing loans ratio in June 2012 was 8.6% of the State Bank of Vietnam, equivalent to approximate USD 9,96 billion (Reuters, 2012).

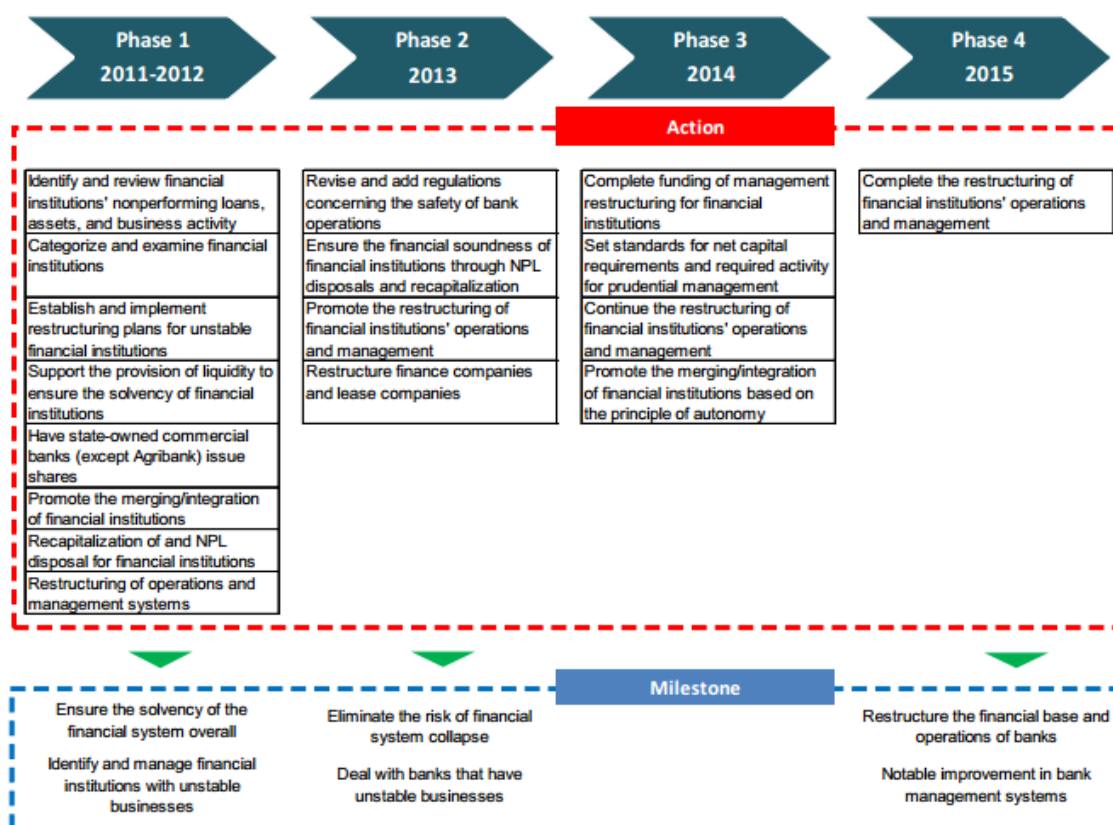
In fact, asset management companies (AMCs) were proved to be more effective in handling non-performing loans in many economies (Klingebiel, 2000). In Vietnam, the State just expressed their determination by the Asset Management Company of Vietnam was established and started operation. This phenomenon is the theme and the reason for the focus on the Asset Management Companies of Vietnam in this section.

4.6.1 The timeline

The key point for banking reforms was the actions to stabilize the macroeconomic. The target included keeping inflation rate below 10%, limiting the budget deficit and trade deficit, raising the amount of investment equivalent to above 30% of GDP, and maintaining economic growth to above 6%. One of the reforms is to solve non-performing, simultaneously with restructuring the banking sector. The State has issued a framework for the banking reform:

- Recapitalize and propose an adequate capital level, equivalent to Basel II
- Promote merger among small banks to increase the liquidity
- Diversify sources of funding, including promoting foreign capital
- Restrict non-performing loans in a reasonable limit
- Improving risk management, including acquiescing corporate with international institutional
- Restrict credit approvals on non-manufacturing sectors; promote investment into the development of infrastructure

Figure 14 The reformed scheme for Vietnam's Banking Sector 2011 – 2015 (Nomura Institute of Capital Markets Research)



The timeline for banking reform can be broken into four phases. The first phase 2011-2012 identified the financial position of the whole sector, including non-performing loans, capital capability, etc. Then, the State Bank of Vietnam chose unstable institutions that threaten the health activities of the system for restructuring even coercing mergers. Additionally, the State Bank of Vietnam boosted up the privatization of state-owned banks, in an effort to improve the efficiency of those institutions. In conclusion, the objective of the first phase is to ensure the solvency of the whole sector, additionally to identify the problematic institutions (Figure 14).

The second phase, taking place in the whole following year, aimed at eliminating risk of financial collapse and focusing on solving the remaining issue. In this phase, the SBV started to recapitalize through purchase non-performing loans via VAMC. The SBV also completes the regulation for lending market (Figure 14).

The third phase (2014) will undertake wide ranges of actions, including finishing recapitalization, updating standards for the credits and lending activities. Notably, in this

phase, the SBV will rearrange mergers and acquisitions among banks and institutions (Figure 14).

The last phase will take place in 2015. In this phase, the SBV will propose to complete the reform, reviewing for the whole actions, and looking for updating reforms.

4.6.2 Action taken by government

Solving non-performing loans and restructuring the banking sector are the top priority concerns of the government. Hence, the action taken by government toward non-performing loans can be deduced from a wide range of policies in an effort to stabilize the macroeconomic.

Firstly, policies to limiting lending to non-production sectors, including real estate, have positive effects to increase liquidity and hedge the expansion of non-performing loans. The State required that banks, which maintain non-performing ratio under 3%, would be eligible for approvals on real estate and non-manufacturing credits. Considering that almost all of the banks in the sector were maintaining above 4% non-performing loans ratio, it could be deduced that credit approvals for real estate and stock market should be insignificant. The significance of this restriction was notable when considering that unhealthy development of credit market had come from credit flows into stock and real estate market. At that time, credit approvals into the stock market and the real estate market has enlarged shortage of the supply to manufacturing sectors, negatively burden the economy.

Secondly, bank merger and acquisitions in the sectors. The State has entailed the State Bank of Vietnam (SBV) to impulse mergers and acquisitions of small banks, which was not able to reach adequate capitals and reasonable non-performing loans. The action proposes to increase the consolidation of the whole system. After the phase one, started in 2011, there were four banks that were coerced to merge with the larger. These mergers and acquisitions included Habubank (acquiesced by SHB), Western bank (merged with PVFC), TinNghia and DeNhat (acquiesced by SCB). In January 2012, Eximbank, the largest banks, purchase entire 9.7 % stake of Sacombank from Australian ANZ banks. In the fourth quarter 2012, Vietinbank prepared to sell 20% stake to foreign investment. In other action, the State Bank of Vietnam claimed to reduce the number of commercial banks to 15 in 2017.

The formation of asset management companies – VAMC, issued in the Decree 53, was one of the actions. The activities and effect of VAMC will be discussed in the later part.

4.6.3 The Asset Management Company

A common approach employed by many nations to solve non-performing loans, asset management companies are effective to reduce non-performing loans in the banking sector. Vietnam has acquiesced AMC as a strong approach to aggressively restructure non-performing loans in the whole sector to below 3% until 2014. From analyzing about recent activity and its effect, it can be appropriate to comment that VAMC has achieved certain progress, yet challenges still remain unsolved, and the effectiveness of the approach is still unconvincing. Experiences from other nations showed that AMC is an approach in a narrow scope, and at a rapid pace, which may be more effective than those with wider objectives of accelerating restructuring (Klingebiel, 2000).

The establishment of VAMC was an effort to alleviate constraints of non-performing loans in the commercial bank sector in Vietnam. The government issued Decree 53, in which VAMC will purchase non-performing loans from credit institutions. VAMC, then, will ultimately decide whether to sell the collateral for cash collection. The decree 53 came to effect on July 2013. Accordingly, the VAMC is organized in the form of one member limited liability company, 100% owned by the State with a chartered capital of US 25 million. VAMC will undertake a wide range of activities, including purchasing non-performing loans, recovering non-performing loans, and restructuring non-performing loans.

In the purchasing activities, the decree entailed VAMC to fund the capital from issuing interest-free bonds, which will be depreciated the face value of non-performing loans in up to five years (Special Bonds). Then, VAMC will purchase non-performing loans from banks at face value, payment of Special Bonds. VAMC will sell non-performing loans to the third parties at over 50% face value. Thus, after five years, VAMC has responsible for paying back the full amount of the outstanding principal. Finally, banks will pay a 20% to 40% commission to SBV. The summary losses during purchasing and reselling non-performing loans will be paid by SBV.

Consequently, banks can dispose of non-performing loans from the balance sheet. Because of the decrease of non-performing loans in the balance sheet, banks can free up an

equivalent amount of cash from eliminating provisioning account. As a result, the liquidity of the system is improved. Banks will get money back at face value at maturity date, in the next five years, and they have to pay 20% to 40% commissions to SBV, depending on the contract.

Another approach is to purchase non-performing loans for cash at market value. In the initial approach, the VAMC is much more a warehouse for non-performing loans, rather than the actual purchaser (David Harrison and Elaine K.Y., 2013). However, the latter approach has never been conducted until now.

Since October 2013, VAMC officially embarked on solving non-performing loans. The Agribank, the largest capital and banking institution, was initially the object. The VAMC agreed to buy approximately US 119 million, at face value, at US 81 million, accounting for relatively 68% face value. The deal was an optimistic signal to market, expressing the State's determination in solving non-performing loans. The deal raised numerous concerns and doubts about the current situation of non-performing loans. Until August 2012, Agribank had non-performing ratio at 6,45%, much higher than number that State Bank of Vietnam (SBV) updated. Experts supposed that non-performing loans of Agribank were probably high because banks typically have very high credit outstanding, of which 70% of the agricultural and rural lending. However, observers argued that, exceed in non-performing (N-PLs) over charter capital is not a normal situation, but a serious issue and should be treated seriously.

Until the end of 2013, VAMC has removed US 2,038 billion of non-performing loans from 40 credit institutions in Vietnam (SBV, 2013). In the latest claim in February 2014, SBV reaffirmed non-performing loans ratio at 3.36%, countering Moody's estimation at 15% (Vietnamnet.vn, 2014). Updated to the newest standard for loan classification, non-performing loans ratio in Vietnam was about 4.73% in October 2013 (SBV, 2013). Hence, based on estimations of the State Bank of Vietnam (SBV), VAMC has absorbed approximately 1.37% of total loans on the whole sectors, equivalent to 29% of non-performing loans.

However, there were no plan and signs, showing how and what the VAMC will do after purchasing non-performing loans. According to the Decree No. 53, VAMC can recover non-performing loans by collecting, and handling to sale collaterals of the purchased assets. VAMC can also restructure non-performing loans by modifying and adjusting

repayment conditions and debt conversion into contributing capital. The Decree No.53 has attached powerful right to the VAMC. VAMC will issue a “Special Bonds” with 0% interest rate toward purchase of non-performing loans with a tenor of a maximum five years (Tuan A.P., 2013). These bonds may be treated as collateral to obtain financing from the State Bank of Vietnam. Hence, the facilitating solution of VAMC is an implicit method to recapitalize for banking sectors in five years. (Harrison D. And Elaine C., 2014)

Generally, it is too incautious to conclude about the effectiveness of the VAMC, but following actions of VAMC after purchasing non-performing loans should be observed carefully. At least, VAMC was able to improve the burden of non-performing loans on the balance sheet of commercial banks.

4.6.4 The Comment

On the Asian Development Outlook (ADO) published in October 2013 by Asian Development Bank (ADB), N-PLs ratio should be three or four times the number that State Bank of Vietnam published. The international rating institution also posed a doubtful view on the N-PLs ratio. Fitch supposed that N-PLs in Vietnam must be over 10%. It can be concluded that the State Bank of Vietnam did not pose an effective measurement and standard to the phenomenon that should be treated with special attention.

According to observers and international institutions, the launch of the VAMC to solve the debt is completely correct. Because of limited charter capital, the action was not strong enough to absorb adequate volume of non-performing loans. The announcement of the VAMC’s establishment was an urgent reaction in the effort of Vietnam against non-performing loans. Excluding all of the additional development of non-performing loans since October 2013, VAMC has absorbed approximately 29% of the total amount of non-performing loans in the whole sectors since the formation of VAMC. The latest updated non-performing loan ratio is about 4,6 %. Based on that number, it can be deduced that non-performing loans can be managed below 3%, accordingly to the plan of the State Bank of Vietnam.

However, there was no explanation how the VAMC will treat those purchased assets. People wonder how VAMC will recover and restructure purchased asset from banks. Many experts suppose that by the limit in activities, the VAMC is an implicit approach

buying time for the banking sector to absorb the burden in the balance sheet gradually by itself. The announcement of the VAMC, in general, is a right footstep of the State in the battle against non-performing loans.

4.7 Recommendations for the solution

4.7.1 Improving standard of valuation and measurement

In any financial crisis, commercial banks fell into common problems. The typical problems included poor asset quality, limited capital capacity, liquidity shortage, poor corporate governance, and risk management practices (Harry H.T. and Thuan Nguyen, 2011). Non-performing is the direct by-product of all the elements. Thus, the solution to managing non-performing should be the centralizations of upcoming policies.

Firstly, report of non-performing loans in the banking system was not consistent. It is impossible to analyze the actual situation with unreliable data. Besides, although most of the banks report the Capital Adequate Ratio (CAR) over 8%, but the non-performing loans ratio at high level would quickly depress the mean of CAR. Deteriorating asset quality leads to increasing impairment charge, burdening the profit, and reducing financial health of banks (Harry H.T., and Thuan Nguyen, 2011). Besides, the financial health and real equity of commercial banks will be meaningful only if the non-performing loans ratio is consistently measured. There is an urgent need to improve the quality of valuation and measurement in banking sections. The best approaches are updated standard of Basel III and IFRS.

4.7.2 Banks proactively tackle the issue

The high level of non-performing loan in the sector shows that debtors might be unable to pay the terms. The banks should write off these loans. The losses will be replaced by the non-performing provision. The conduction of writing off the loans will help banks to reduce the volume of provisioning funds, reducing operational cost. The removal of non-performing loans in the balance sheet will allow banks to improve its credit rating. Overall, the writing of non-performing loans will help banks to rejuvenate and improve the financial position.

Banks can promote recovering and restructuring process. Recovering and restructuring is more gentle approaches, but the conduct of those approaches will cost a huge amount of time. However, restructuring and recovering are effective in reducing non-performing loans, and in alleviating shock to banks.

4.7.3 Relief from national budget

The state will directly supply funds to banks to completely absorb non-performing loans. However, this solution is not feasible because of a conflict with tightening monetary policies. Besides, the context of the budget deficit will not allow government spending for solving non-performing loans. The State can establish asset management to solving the problem, VAMC for example. This is the most feasible approach to tackle non-performing loans. VAMC will purchase non-performing loans from banks as financial assets, paying and a “special bond”, due in five years. The “special bond” is the corporate bonds, available for freely trading in the OTC market. Thus, the approach is a buying time method for banks to handle non-performing loans completely.

4.7.4 Fostering the investment of foreign capital

The participating of the foreign investor is a valuable opportunity to tackle non-performing loans. Besides, the approach will foster the process of acquiescing management experiences from development capital market. However, the approach requires opening room to foreign investors who are not encouraged by the government for political reasons.

DISCUSSION

4.8 Conclusion

In the trend of integration in the world, the economy, in general, and the banking system, in particular, is facing opportunities and challenges. The needs to reform and increase capital capacity becomes imminent. The most important mission would be solving non-performing loans to increase asset performance of the banking system. After all, it is appropriate to recommend feasible solutions to manage non-performing in an optimize limit. For the urgent demand above, researcher undertook objective of the research.

Firstly, the research has found that there are four main reasons responsible for non-performing loans in Vietnam. Firstly, the poor asset quality was a significant reason. Approval for credit and loans in Vietnams has been a long time based on collateral, but ignoring the analysis about payment ability. As the result of the economic slowdown, the real estate market and the stock market were collapsed. Banks, at that time, were holding loans with devaluated collateral. Secondly, the accumulation of non-performing loans increased the provision account in the balance sheet, leading to capital shortage. Thirdly, the shortage of capital capacity makes banks seeking funding and financing at high cost. High financing cost, combining with a huge amount of non-performing and provisioning, increases costing structure of the banks. Lastly, banks become faced with the shortage of liquidity because of difficulties both in funding and in collecting credits. Along with all of the weaknesses in banking sectors, the original cause was the poor corporate governance and risk management practices.

Secondly, the research has shown the effect of non-performing loans on the economy in Vietnam. Similar to other markets, Vietnam experienced potential influences from non-performing loans to the economy in a widespread area. The research has shown that non-performing loans directly influence the capital adequacy of banks and financial institutions. Hence, the development of non-performing loans in the financial market threatened the operation of the economy. In fact, the researcher, shown that non-performing loans ratio at over nine percent in 2011 was a major reason of high inflation

interest rate. At that time, interest rate relatively remained over ten percent, at which many experts agreed that the economy would be hampered.

Besides, further investigation in the ending year 2013 shows that when non-performing loans was isolated and resolved, the economy experienced very promising signs. By analyzing tendencies of GDP growth rate, interest rate, and inflation rates, the researcher found that the improvements of macroeconomic condition were relatively substituting with the improvement of the capital market. Especially, the resolution of non-performing loans was dominantly concerned. This factual situation has also proven the assumption above. The researcher believed that efforts to pull down non-performing loans ratio of 3,5% in the end 2013 has solved challenges of the capital market in Vietnam. The enhancement of capital flow directly improved manufacturing activities of the economy. Particularly, research findings show that GDP growth rate was stable at approximate 5.5%, and on the increasing trend for the ending year 2013. Additionally, the inflation rate was controlled at approximate 6%. Considering that Vietnam was the one of margin market in Asia, a 6% inflation rate was a safe area, ensuring the dynamic growth of the economy while keeping threats of deflation in control. To sum up, the researcher believes that non-performing loans have widespread effects on the economy in Vietnam. Hence, the threats of non-performing loans should be concerned watchfully.

Thirdly, the research described the development of non-performing loans. From different sources, the researcher estimated that the non-performing ratio peaked at 9,6% in 2011, in which two-thirds belong to SOEs. The non-performing loans hold of the real estate and stock market was also notable, substituting for total 17% non-performing loans in 2011. Hence, non-performing loans from real estate, stock, and SOEs were the main objects for urgent treatment. The State has started solving the issue by simultaneous policies in the long term and short term. In the short term, the State Banks of Vietnam established the Asset Management Company of Vietnam to solve the liquidity of banks, through disposition of non-performing loans. In the long term, the SBV solved the solvency problems by issuing restricted standards for credit approval, corporate governance, and risk management practices. Until present, the resolution of non-performing loans in Vietnam has solved urgent desires, and non-performing loan ratios decreased to approximately 3,5% at the end of 2013. However, the VAMC showed no evidence regarding absorbing the non-performing loans completely. Despite disposed

of, non-performing loans still existed in the capital system. In fact, the non-performing loans still threatened the stability of capital markets. The initial success from resolution of non-performing loans has shown that absorbing completely non-performing loans has factual benefits to the economy. The State Banks of Vietnam have scheduled a timeline for controlling non-performing ratio below three percent in 2015. Hence, solving non-performing loans will be a notable desire in the following years.

Finally, the research offered solutions for limiting the negative effects of non-performing loans in Vietnam, including improving valuation and measurement, facilitating either restructuring, closing loans, and supporting the investment of foreign capital. It is appropriate to emphasize that a large volume of non-performing loans was only disposed, was not resolved completely. The improvement of macroeconomic conditions was mainly the result of the recapitalization of banks and financial institutions. The fact showed that the State Banks of Vietnam remained resistance to solve non-performing loans. The researcher supposed that non-performing loans might be not absorbed by any approach. It seems that the State Banks of Vietnam will try to isolate non-performing loans in VAMC to improve macroeconomic conditions in the following years. The SBV will wait for better condition to return those non-performing loans back to banks. If the scenario is the case, the resolution of non-performing loans was just taking a time approach.

In a nutshell, the researcher hopes that the research will be a reference for investors to the actual phenomenon of non-performing loans in Vietnam. In the last section, the researcher provided feasible solutions that would be adopted by the State Bank of Vietnam. The content is possibly the tendency of non-performing loans, in particular, and banking transform and reform, in general.

4.9 Limitation

The research was conducted on a relatively short of time, and the results are not too thoroughly. However, considering that information and data about the objective remain ambiguous, the researcher has tried to investigate and analyzed the objective in a reasonable limit. Base for the aims and purposes of the research, researcher succeed in monitoring and explaining the phenomenon of objective. The researcher has tried to answer for the main question, including the reasons of development of non-performing

loans in Vietnam. However, non-performing loan is a complex phenomenon, with widespread influence on the economy. Additionally, the actual phenomenon of non-performing loans was not completely disclosed. Hence, the phenomenon of non-performing loans cannot be completely monitored in the scope of this thesis. Because non-performing loan is a very notable topic, further investigations about non-performing loans are also very worthy. For example, the researcher believes that a comprehensive study about non-performing loans resolution during 2011 – 2015 is a notable enhancement. In other actions, Mr. President Nguyen Tan Dung has stated that the government efforts to increase the capability of banks, in which the market has about 17 banks, with non-performing ratio below 3% in 2015. Considering that the scenario above is significantly different from the present situation, the researcher supposed that this topic would be worthy in the following years.

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