



"Is it hot in here or is it just the economy?"

Vietnam's banking sector presents some of Asia's biggest opportunities and challenges.

# The right way to break into Vietnam banking

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BAIN & COMPANY

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## Vietnam's economy is small, its people are poor and its infrastructure is fragile.

The country's industries are still largely run by central planners. Yet, at this moment, Vietnam just may be one of the world's most attractive new opportunities for financial services companies.

For global banks drawn to Vietnam, a key consideration there, as in all emerging countries, is what's the appropriate level of risk? Part of the appeal of Vietnam's banking sector lies in the rapid pace of change. Since embarking on *Doi Moi*, the market-opening national renewal program launched in the mid-1980s, Vietnam has zipped into Asia's economic fast lane. Gross domestic product (GDP) growth, which has been running at better than a 7% annual rate over the past five years, is forecast to top 8.5% in 2007, to reach \$62 billion.

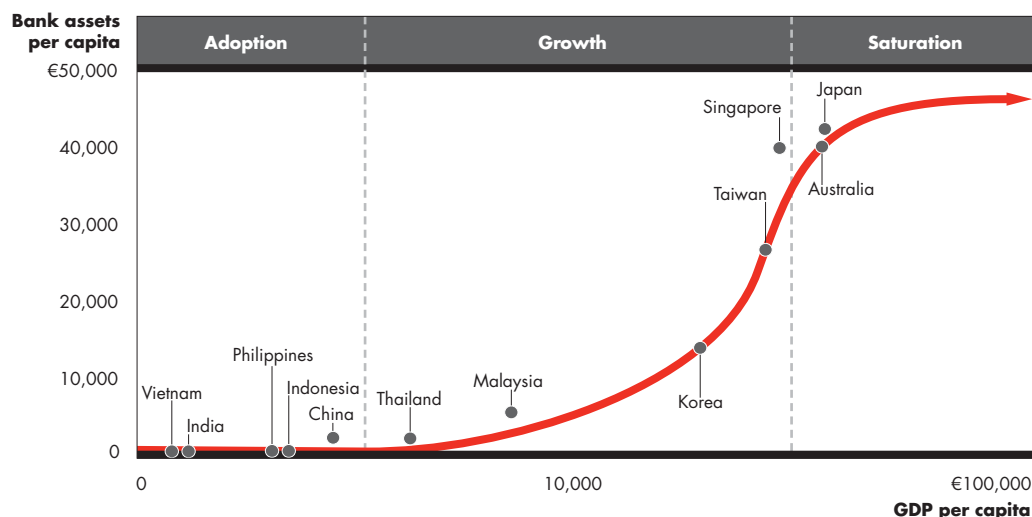
Meanwhile, capital is pouring into the country at a record clip—foreign direct investment applications are expected to reach \$16 billion

this year, up 57% over 2006. Since 2000, bank loans and deposits have each grown at a 26% compounded annual rate, with both surpassing \$30 billion in 2006. (See Figure 1.)

International banks can soon look forward to participating on more equal terms in the country's growth. Vietnam agreed late last year to open its economy—including its financial services sector—to global competition under World Trade Organization rules. Leading European banks—including HSBC, Standard Chartered, Deutsche Bank and BNP Paribas—and major Asia-Pacific institutions like ANZ Bank, Cathay Bank and OCBC Bank are strengthening their ties with local institutions and opening independent branches.

For now, a foreign bank willing to hold on to its investment for a minimum of five years may acquire up to 15% of the equity in a Vietnamese partner bank, with total foreign ownership in a local bank capped at 30%. But those constraints will likely ease in coming years, giving early entrants a head start on the competition. By 2010, international banks will be permitted to accept local-currency deposits from ordinary consumers on the same terms as their domestic competitors.

Figure 1: Vietnam's banking market is in an early stage of development



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Recent arrivals that hope to capitalize on Vietnam’s new openness will want to focus on three priorities: First, they should expect to bring more than capital to the partnerships they forge with local institutions; they will also have to provide technical expertise and management know-how.

Second, foreign banks will need innovative business models to crack this still unformed market; conventional techniques used to attract customers in Asia’s bigger emerging markets won’t suffice.

Finally, as they concentrate on building their presence in Hanoi and Ho Chi Minh City, foreign banks cannot afford to overlook the untapped opportunities in the provincial towns and rural areas where the bulk of the population lives.

**Bring capabilities, not just capital**

Vietnam’s four big state-owned banks are readying themselves for the new competitive challenges ahead by purging their balance sheets of nonperforming loans and preparing for partial sale to private investors. This summer, for example, Hanoi-based Vietcombank, the country’s second-largest lender, will begin selling shares through an initial public

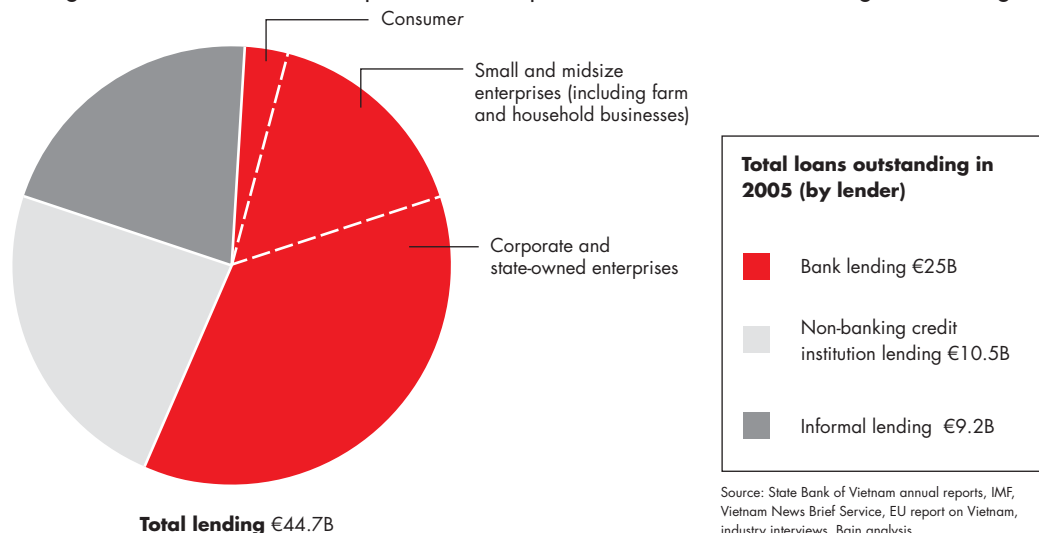
offering (IPO) on the Hanoi bourse. Over the next two years, five of the country’s biggest banks will launch IPOs.

Meanwhile, Vietnam’s 32 joint-stock commercial banks are maneuvering to raise their profiles. These scrappy market-oriented institutions are looking to raise cash through share issues and directly through investments by foreign banks to help them meet new government mandates that they expand their capital bases. (See Figure 2.)

Tapping new sources of capital is by no means the biggest challenge the local banks face. The financial commitment a foreign bank must make to establish a presence in Vietnam is relatively modest. Compared with their counterparts in Thailand, Indonesia, the Philippines and Asia’s other emerging economic tigers, even the biggest Vietnamese banks are small. Assets of the joint-stock commercial banks, for example, typically total well below \$500 million, less than one-tenth the size of their counterparts in China or Indonesia.

More than infusions of funds, Vietnamese banks are looking to foreign partners to help them get a leg up on the competition. The

Figure 2: State-owned enterprises and corporate borrowers are the largest loan segments



Source: State Bank of Vietnam annual reports, IMF, Vietnam News Brief Service, EU report on Vietnam, industry interviews, Bain analysis

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domestic banks most need up-to-date products, back-office technologies, stronger corporate governance to ensure greater financial transparency and management accountability, and other capabilities they lack today. As they establish ties to local partners, forward-looking international banks will want to work with them to lay the foundations for long-term growth.

For HSBC, that means pursuing a two-track strategy. First opening a correspondent office in 1995, the big UK bank is now teaming up with a local partner to cater to consumers and local small and midsize businesses while building a network of wholly owned subsidiary branches to serve its larger corporate accounts. In 2005, HSBC purchased a 10% stake in Technological and Commercial Joint Stock Bank (Techcombank), a Hanoi-based joint-stock bank with 73 branches scattered across 16 provinces, for \$17.3 million.

In addition to the cash, HSBC also committed to transfer transaction-processing technology to increase Techcombank's capacity to serve more account holders, develop better risk-management skills, strengthen customer-service disciplines and introduce internal audit capabilities. The partners' goal is to more than double the number of Techcombank branches, to some 200 by 2010. Meanwhile, HSBC is also building out its two commercial banking outlets in Hanoi and Ho Chi Minh City, with plans to expand to as many as 15 big-city branches when regulators allow.

Anticipating what it will take to accomplish this ambitious expansion, HSBC-Vietnam's senior managers have zeroed in on what they see as the biggest bottleneck. "The big challenge is not to find customers; it's to be able to recruit enough staff, to train them and to retain them," says HSBC-Vietnam president and CEO Alain Cany. "There is such a lack of skilled bankers in the market, and the demand is becoming exponential." To address the

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shortfall, HSBC is rolling out a comprehensive management development program to build a pipeline of Vietnamese executives to staff positions both in Techcombank and within HSBC itself.

The program begins by offering online training sessions to build basic management skills. Promising candidates are sent on to HSBC's Management/Leadership Assessment Centre and Development Programs, where they are groomed for higher-level responsibilities. As local managers rotate through assignments and gain experience at Techcombank, the best performers are tapped for overseas training and fast-tracked for senior positions with HSBC.

Beyond its own four walls, HSBC is spreading its know-how to Vietnam in other ways. For example, the bank recently agreed to work with the finance ministry to develop a domestic bond market, strengthen credit rating agencies, train ministry officials in risk management and implement the government's fund-management strategies. This in-kind investment in strengthening Vietnam's financial infrastructure is apt to reap dividends in goodwill when the bank needs regulatory sanction to expand its activities.

### **Creative business models needed**

Vietnam is largely undeveloped territory for banking services. Out of a total population of 84 million people, just 5 million have a personal bank account, and only 2% have ever taken out a bank loan. Even in the biggest cities, consumers' use of bank services is still rare. Only about half of Hanoi's residents and fewer than a third of those living in Ho Chi Minh City have bank accounts.

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City dwellers are eager to embrace modern financial products. The number of credit card holders has jumped 300% since 2004, to some 2 million, and demand for loans to finance the purchase of motorbikes, cars and apartments is heating up. But with an annual per capita income of just \$650 and more than a third of the population living below the poverty line, the opportunities for banks in the short term will lie elsewhere. Reaching Vietnam's low-income customers requires a nimble, innovative approach. Our research in other developing markets shows that the top-three banks typically end up dominating 50% or more of the market, while their slower competitors are forced to compete for what's left.

One example that may offer valuable lessons is Banco Agrícola's success in matching entry-level products and easily accessible distribution channels to the basic banking needs of poor customers in Central America. BA was a leader serving small-business accounts and the narrow stratum of middle-income and affluent retail customers. The bank's market researchers showed that the potential demand for banking services was strong among the poorest majority of the people in the markets where it operated. But they concluded that the high fixed costs of BA's extensive network of full-service branches and wide array of deposit accounts, collateralized loan products and credit cards simply made it impossible to serve them profitably.

Rather than write off this vast, hard-to-reach customer segment, the bank set out to streamline its product offerings radically. Instead of full-service branches offering collateralized mortgages and other asset-backed loans, BA opened small, customer-friendly personal-credit centers where borrowers could take out small personal loans repayable in modest monthly installments, and it began issuing low-limit credit cards for use with local merchants. BA also created two new entry-level transaction accounts serviced through debit cards and automated kiosks to keep costs to

### Vietnam consumer banking at a glance

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a minimum. The no-frills approach has been a big hit, doubling the bank's potential profit pool and generating, by BA's estimates, a better than 30% return on equity.

#### Plant roots in the countryside

Some of Vietnam's biggest unmet banking opportunities are in the rural communities and provincial villages where three-quarters of the population reside, some 70% of its small and midsize businesses are based and hunger for credit is strong. Since a mid-1990s legal reform gave farmers effective property rights in their small plots, Vietnam has become self-sufficient in food production, and the country is now the world's second-largest exporter of rice (after Thailand).

The availability of formal banking services outside of Vietnam's big cities is patchy. The Vietnam Bank for Agricultural and Rural Development, a big state-owned bank, operates a fleet of vans that travel from village to village, providing small crop and business loans. But Vietnamese villagers continue to rely on an informal network of moneylenders, clan associations and family members to meet more than half

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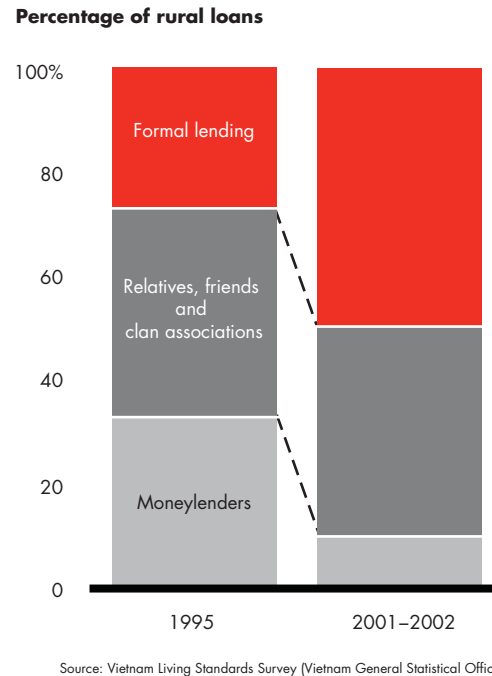
of their financial needs. Though expensive and often undependable, these traditional sources of capital have made provincial Vietnamese savvy borrowers. Innovative banks can build on rural dwellers' familiarity with the use of credit to attract a loyal customer base. (See Figure 3.)

The biggest obstacle bankers face is finding cost-effective ways to deliver financial services in geographically isolated and thinly populated communities. Here's how ICICI Bank is mobilizing resources efficiently to bring banking services to rural India. The bank is teaming up with telecommunications partners to install wireless ATMs.

The bank is also working with village shopkeepers, leasing them low-cost kiosks that offer a range of deposit and credit products via the Internet and training them to help sell specially designed credit, insurance and even investment products to their rural neighbors.

For example, ICICI offers small farmers bridge loans to help span the time from the sale of last season's harvest to the purchase of next season's seeds. The bank charges an interest rate of 9% to 11% a year, compared with 2% a month from moneylenders, who often take an additional cut once the asset is sold. The bank also offers personal-accident insurance through these rural outlets for just \$2 a year, with a payout of about \$2,200 in the event of death and half that amount in case of a debilitating injury. And ICICI Bank is developing micro-investing products, enabling rural laborers and landless farmers to buy a mutual fund for the equivalent of about \$2 and then add to their investment in increments as small as two cents. Based largely on these promising initial results, ICICI has made its rural banking operations a stand-alone division, generating \$32 million in net interest income in 2004.

Figure 3: About half of all rural loans are from informal sources



With an energetic young workforce, export-oriented industrial and agricultural sectors, a flair for entrepreneurship and now a new openness to foreign investment, Vietnam is on the cusp of achieving self-sustaining growth that will move its people to prosperity. Adapting banking techniques that have worked in other emerging markets to Vietnam may prove to be an effective way to get started, although Vietnam will undoubtedly chart its own course as it continues to develop. International banks that lend their skills and creativity to help Vietnam build the financial infrastructure it will need to take its place among the developed nations will share in that promising future. 🕒



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