The Impact of Foreign Ownership on Credit Risk of Commercial Banks in Vietnam: Before the Context of Participation in the CPTPP

Thi Bich Duyen PHAM[1]

Abstract

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is projected to provide several chances for Vietnam's banking industry to expand into the international market. This study examines the influence of foreign ownership on credit risk in Vietnamese commercial banks before the context of participation in the CPTPP. Using a sample of 28 commercial banks between 2009 and 2020, we find that foreign ownership has a negative relationship with bank credit risk. The regression methods used include the least-squares method, fixed-effects model, random effects model, and general least squares method. The research model adds interactive variables, which will help to reflect the role of intermediary factors more accurately such as listing on the stock market, capital ratio to the relationship between foreign ownership and bank credit risk. The test results reveal that increasing the foreign ownership ratio has a bigger impact on reducing credit risk for listed banks and banks with low capital than for other commercial banks. The government should flexibly adjust the foreign ownership ratio according to the capital size and role of each bank so that it can make good use of investment capital from abroad when Vietnam joins the CPTPP.

Keywords: Commercial Bank, Vietnam, CPTPP, Credit Risk, Foreign Ownership

JEL Classification Code: G21, G28, G32

1. Introduction

Currently, Vietnam has become an official member of many global economic and financial organizations as well as signed many free trade agreements. Among them, the most prominent is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which officially took effect with Vietnam on January 14, 2019. This is the first and only agreement that establishes the investment legal framework in the banking and finance sector in a separate chapter.

Regulations on liberalization in the service sector make money circulation in CPTPP countries convenient, exchange rates stable, and direct and indirect investment flows into Vietnam increase sharply, promoting economic growth, increasing domestic production, and stimulating and promoting exports (Le, 2021). As a currency trading enterprise providing banking services for the economy, Vietnamese commercial banks have become an important bridge for businesses' business activities, in which bank credit capital and goods have become an indispensable source of funding for import and export activities. However, the asset size, financial capacity, technology infrastructure, and payment systems of Vietnamese banks are not small compared to the region and the world, which is a potential credit risk.

Investment capital from foreign shareholders is expected to be an important channel to help banks in Vietnam expand their scale, improve liquidity, and development level and thereby contribute to minimizing credit risk. With the ratification of the CPTPP, the financial and banking sectors will expand further according to common commitments, creating favorable conditions for CPTPP member countries like Vietnam to have the opportunity to attract foreign investment capital into the banking sector.

Several studies have focused on the impact of foreign ownership on the bank performance (Lensink & Naaborg, 2007; Abraham, 2013; Tacneng, 2015); financial stability (Lee & Hsieh, 2014); credit growth (Feyen et al., 2014); liquidity risk (Vo & Mai, 2017). The research results show

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[1]First Author and Corresponding Author. Head, Department of Finance–Banking and Business Administration, Quy Nhon University, Binh Dinh, Vietnam [Postal Address: 170 An Duong Vuong Street, Quy Nhon City, Binh Dinh Province, Vietnam] Email: phamthibichduyen@qnu.edu.vn

that the role of foreign shareholders has become an urgent issue in practice for the banking system. However, in terms of credit risk, relevant theoretical and empirical literature provides conflicting results on the impact of foreign ownership on credit risk in banks. Saunders et al. (1990), Lee (2008), Kobeissi and Sun (2010), and Amor (2017) said that the higher the foreign ownership ratio, the higher the credit risk. Meanwhile, the research results of Laeven (1999), Agoraki et al. (2011), Ehsan and Javid (2018), and Pham and Pham (2021) provide evidence to the contrary.

Thus, the controversy about the impact of foreign ownership on credit risk at commercial banks has not come to an end. The new point of the study is the addition of interactive variables, which will help to reflect the role of intermediary factors more accurately such as listing and capital ratio, on the relationship between foreign ownership and bank credit risk. In addition, some control variables belonging to inside and outside the bank are also included in the research model to reduce the possible confounding effects on other variables. The results of the study provide more empirical evidence demonstrating the role of foreign shareholders in credit risk management.

2. Literature Review and Hypotheses

The impact of foreign ownership on credit risk has inconsistent research results. Many studies show that foreign ownership has a negative effect on credit risk. Research by Laeven (1999) on commercial banks in East Asia confirms that foreign-owned banks have less credit risk than other banks. Agoraki et al. (2011) research on risk at banks in emerging economies shows that foreign ownership reduces risk in these banks. Ehsan and Javid (2018) argue that the cause of foreign investors is often characterized by effective management, advanced technology, abundant capital, and good supervision mechanisms (Duong et al., 2021). Besides, they also have many experts with full professional skills and an international reputation.

However, Saunders et al. (1990), a study in the US in the period 1978–1985 or Lee (2008) in Korea in the period 1999–2006, suggested that banks with a large foreign ownership ratio would have higher credit risk. Kobeissi and Sun (2010) analyze that banks with foreign ownership will face difficulties and challenges in understanding and adapting to specific standards of the domestic market. This will increase operating costs and increase credit risk. In addition, according to Amor (2017), foreign investors often nominate more foreign managers for the bank's management apparatus. These managers may not be fully aware of the facts and conditions in the local market, so they may introduce inappropriate standards and policies. This indirectly increases credit risk.

In Vietnam, large foreign shareholders often transfer management and technology to domestic banks, improving the quality of human resources and labor productivity. The spillover effect of governance, technology, and personnel from foreign shareholders helps domestic commercial banks increase operational efficiency and reduce costs and credit risks. Therefore, we expect a negative relationship between the foreign ownership ratio and the bank's credit risk. Specifically, the first research hypothesis is put forward as follows:

H1: The higher the foreign ownership ratio, the lower the credit risk of the bank.

Theoretically, banks listed on the stock market must meet many constraints: properly and fully comply with accounting standards and ensure the transparency of financial analysis to investors. Therefore, these banks always try to keep risks as low as possible, especially credit risk. Research by Le and Nguyen (2017) shows that officially listed banks (on HNX and HOSE) have more effective credit risk provisions than other banks. Duong and Nguyen (2019) found that banks listed on the stock market may be less risky than unlisted banks due to stricter controls from the State Bank, Securities Commission, audit units, and pressure from investors. Pham and Pham (2021) found that after Vietnamese commercial banks are listed on the stock market, capital increases will have a stronger effect on reducing credit risk than unlisted banks. To sum up, we put forward the second hypothesis as follows:

H2: The negative effect of state ownership on bank credit risk will be stronger for banks listed on the stock market.

Jacques and Nigro (1997) and Das and Ghosh (2004), conducting research at US commercial banks and public sector banks in India, all find that banks with more equity have less credit risk. Zhang et al. (2008) and Tan and Floros (2013) studied Chinese banks with similar results. Bouheni and Rachdi's (2015) research at the largest banks in Switzerland found that a capital increase is followed by a decrease in bank credit risk. In addition, multinational studies such as González (2005) used data from 251 banks in 36 countries, and Lee and Hsieh (2013) studied banks in 42 countries in Asia. These studies all suggest that lower equity values encourage banks to increase credit risk.

However, while Shrieves and Dahl (1992) studied in the United States, Altunbas et al. (2007) analyzed European commercial banks, showing a positive relationship between credit risk and equity. These studies indicate that an important factor contributing to the positive relationship between equity and credit risk is related to the actions of managers and supervisors. According to this hypothesis, managers incentivize banks to raise capital commensurate with the amount of risk. This study expects foreign ownership to have

a stronger credit risk-reducing effect on low-capital banks. The research hypothesis is formulated as follows:

H3: The negative effect of foreign ownership on bank credit risk will be stronger for banks with low capital.

3. Methodology

3.1. Data

Banks' data is collected from the audited financial statements of 28 Vietnamese banks, and macroeconomic data is collected from the Asian Development Bank's Statistical Database System. To test the impact of ownership structure on bank credit risk in the period 2009–2020, the study uses the following models: OLS, FEM, REM, and GLS. Besides, some necessary tests are carried out to detect the model's hypothesis violations as well as select the most suitable and reliable model. The research uses Stata software to process the regression results.

3.2. Measure Variables

3.2.1. Foreign Ownership

According to the provisions of Decree 01/2014/ND-CP, the share ownership ratio of a foreign strategic investor cannot exceed 20% of the charter capital of a Vietnamese credit institution, and the total ownership percentage of foreign investors in a domestic credit institution must not exceed 30% (Government, 2014). Similar to Vo and Mai (2017) and Nguyen et al. (2020), we use the foreign ownership ratio (FO) to represent the foreign ownership variable and it is calculated as the total shares held by foreign shareholders divided by the total number of outstanding shares.

3.2.2. Credit Risk

The ratio of provision for loan losses to total outstanding loans shows how much of a bank's reserves for credit losses account for the total outstanding loans. This index also indicates the quality of credit activities because a high loss reserve means that the loan is of low quality, which means high credit risk. To measure bank credit risk (CR), similar to previous studies (Altunbas et al., 2007; Iannotta et al., 2007; Tan & Floros, 2013; Nguyen et al., 2020; Le & Nguyen, 2017), we use the loan loss provision ratio to total outstanding loans.

3.2.3. Interactive Variable

To test the impact of listing on the relationship between foreign ownership and credit risk, we added to the regression model the interaction variable FO × LISTING. The LISTING variable receives a value of 1 for commercial banks listed on the stock market and a value of 0 for the opposite cases.

Another factor that can influence the relationship between foreign ownership and credit risk is the equity ratio of banks. The interactive variable FO × HIGH_CAPITAL is added to the model to test whether when Vietnamese commercial banks have different capital levels, there is a change in the impact of foreign ownership on credit risk. The low- and high-capital banks are distinguished using the sample median year as the cutoff. The variable HIGH_CAPITAL takes on a value of 1 for high-capital banks and a value of 0 for the rest of the observations.

3.2.4. Control Variable

Regarding the control variables, we use some variables at the bank level and at the macro level that can affect a bank's credit risk as follows:

Bank size (SIZE)
This study uses SIZE as the natural logarithm of total assets. Bouheni and Rachdi (2015) show a negative relationship between bank size and credit risk.

Capital ratio (EA)
According to Bouheni and Rachdi (2015), capital plays an important role in reducing the credit risk of banks. We add to the model the variable EA, which is the ratio of capital to total assets.

Economic growth (GDP)
GDP growth rate. Evidence shows that GDP affects bank performance through monetary policy shocks (Jiménez, 2012).

Inflation (INF)
Inflation rate. Boyd et al. (2001) show the effect of inflation on lending and financial market performance in a country.

3.3. Research Model

The research model is based on an overview of studies and the current situation in Vietnamese banks. From the identification of variables and how to measure them, the research model has the following form:

$$CR_{i,t} = \alpha + \beta\, FO_{i,t} + \eta' X_{i,t} + \rho' C_t + \chi_i + \varepsilon_{i,t}$$

where:
- i, t: Corresponding symbols for the bank and time (years);
- α: Constant;
- β, η, ρ: Coefficients of the independent variables in the model;
- $\varepsilon_{i,t}$: Random error;

$X_{i,t}$: A vector of control variables at the bank level, such as bank size and capital ratio;

C_t: A vector includes control variables at the macro level, such as economic growth and inflation;

χ_i: A set of interacting variables that are used to control for the fixed effects of banking factors.

4. Empirical Results

4.1. Descriptive Statistics

Table 1, descriptive statistics of the whole sample, shows that the average credit risk is about 1,329, of which the largest value is 3,970. Considering the foreign ownership ratio, the average FO of banks in Vietnam is 9,162%. With regard to several control variables, sample statistics show that the mean size is 5,040. Banks hold an average of 9,102% equity in total assets. In the sample, the average GDP growth rate over the years is 5.946%, with a corresponding inflation rate of 5.898%.

4.2. Correlation Matrix

Table 2 shows the correlation coefficients between the independent variables. We find a low correlation between the explanatory variables of the model. Notably, the correlation coefficient between CR and FO is negative, consistent with

hypothesis H1. This result provides preliminary evidence that there exists a negative relationship between state ownership and the credit risk of Vietnamese commercial banks. Besides, the VIF of all independent variables is less than 10. From this result, it can be concluded that multicollinearity in the research model is not serious.

4.3. Foreign Ownership and Credit Risk

Table 3 presents the estimated results of the study to test Hypothesis H1. Testing the selection of a suitable model for the research sample through the F-test (p-value < 0.05), Breusch-Pagan test (p-value < 0.05), and Hausman test (p-value > 0.05) shows that the REM model is the best fit at the 5% significance level. Next, we perform a defect test of the research model. The results of the Woolldridge test and White's test (p-value < 0.05) show that there is autocorrelation and heteroskedasticity for REM. To minimize the influence of defects, we use the GLS model.

Table 3: The Impact of Foreign Ownership on Bank Credit Risk

Variables	REM	GLS
	(1)	(2)
FO	−0.013***	−0.011***
SIZE	0.455***	0.410***
EA	0.020*	0.015**
GDP	−0.028	−0.023
INF	0.025***	0.017***
F-test	0.000	
Breusch-Pagan test	0.000	
Hausman test	0.813	
Woolldridge test	0.000	
White's test	0.000	

Note: *, **, and *** indicate statistical significance at the 10, 5, or 1% significance level, respectively.

Table 1: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
CR	332	1.329	0.553	0.210	3.970
FO	332	9.162	11.490	0.000	30.000
SIZE	332	5.040	0.510	4.199	6.003
EA	332	9.102	3.725	4.680	18.450
GDP	332	5.946	1.106	2.910	7.100
INF	332	5.898	4.628	0.600	18.600

Table 2: Correlation Matrix

Variables	CR	FO	SIZE	EA	GDPG	INF	VIF
CR	1.0000						
FO	−0.1161	1.0000					1.23
SIZE	0.2513	0.3795	1.0000				2.33
EA	−0.1394	−0.1201	−0.6902	1.0000			2.04
GDP	−0.0655	−0.0276	0.0109	−0.0872	1.0000		1.01
INF	0.1655	−0.1355	−0.2475	0.2268	−0.0534	1.0000	1.08

Research results in column (2) show that FO has a significant and negative effect on CR. The regression coefficient of the variable FO is –0.013 and is statistically significant at 1%, supporting our hypothesis that increasing foreign ownership will have the effect of reducing the credit risk of banks.

When considering the control variables, we find that banks with a large size and a high capital ratio have higher credit risk. Specifically, EA has a positive impact on the credit risk of Vietnamese commercial banks. This result supports the theory of management, similar to the study of Altunbas et al. (2007). According to this theory, management often requires banks to increase equity in proportion to the level of credit risk, so that the relationship between bank capital and credit risk is determined to be positive. That is, as the risk increases, the bank's capital also increases. Thus, it can be seen that an important factor contributing to the positive relationship between capital and credit risk is related to the actions of managers and supervisors. The variable "size" has statistical significance and has a positive impact on credit risk. One of the reasons that can be mentioned is that big banks are often riskier in lending. In addition, large banks have often experienced rapid growth. At a certain stage, this growth is likely to exceed the management capacity of the executive apparatus, potentially posing a higher credit risk than banks of moderate size and high flexibility.

Macroeconomic conditions also significantly affect a bank's credit risk. Specifically, INF has a positive effect on CR and has a statistical significance of 1%, indicating that an increase in the inflation rate will increase the credit risk of Vietnamese commercial banks. Part of the reason is that inflation has a significant impact on the ability of customers to pay interest and repay loans.

Summarizing all the results, we provide solid evidence in support of Hypothesis H1. Foreign ownership reduces the credit risk of banks. This result is consistent with the previous findings of Laeven (1999), Agoraki et al. (2011), and Ehsan and Javid (2018). This can be explained by the fact that foreign investors will help domestic banks have more working capital, improve management skills, and transfer technology. In addition, banks can take advantage of investors' experience in exploiting business strategies to reduce credit risks.

4.4. Effect of Listing and Capital Ratio

The results of testing Hypotheses H2 and H3 are presented in Table 4. We add to the regression model the interactive variables FO × LISTING and FO × HIGH_CAPITAL. These variables are used to test the impact of listing and capital on the relationship between foreign ownership and credit risk. The results of selecting a suitable model for the research sample through testing show that the REM model is the most suitable at the 5% significance level. Next, the author

Table 4: The Impact of Listing and Capital on the Relationship of Foreign Ownership on Bank Credit Risk

Variables	REM	GLS
	(1)	(2)
FO	– 0.014**	– 0.007*
FO × LISTING	– 0.006	– 0.008**
FO × HIGH_CAPITAL	0.011***	0.006**
SIZE	0.381***	0.359***
GDP	– 0.031	– 0.029
INF	0.025***	0.018***
F-test	0.000	
Breusch-Pagan test	0.000	
Hausman test	0.524	
Wooldridge test	0.000	
White's test	0.001	

Note: *, **, and *** indicate statistical significance at the 10, 5, or 1% significance level, respectively.

tests the defects in the research model. The test results also show that there is autocorrelation and heteroskedasticity with REM. To overcome these phenomena, we use the GLS model.

The results show that the regression coefficient of FO × LISTING in column (2) has a negative value and is statistically significant at the 5% level. This shows that the negative relationship between FO and CR of banks is more evident for banks listed on the stock market. This hypothesis shows the important role of a bank's listing in enhancing the negative impact of foreign ownership on credit risk. Once listed on the stock market, banks must have a responsibility to disclose operational information more clearly and frequently to increase transparency and help the bank develop sustainably in the long term. In addition, the listing also allows investors and depositors to evaluate the performance of each bank fully and more accurately. For this reason, banks must always improve their reputation, and brand name and strictly control risks in operations, especially credit risk. One mistake can seriously affect not only the stock price but also the bank's business. For example, facing pressure to withdraw money from customers or other unpredictable consequences. Therefore, the impact of the increasing foreign ownership ratio on credit risk at listed banks will be stronger than at other banks.

The test results also show that the regression coefficient of FO × HIGH_CAPITAL has a positive value in column (2) and is statistically significant. This evidence suggests that the negative relationship between foreign ownership

and bank credit risk is more significant for low-capital banks. The investment of foreign strategic shareholders will help weak banks quickly strengthen their financial strength and accelerate the restructuring process for early recovery. Besides, increasing the foreign ownership ratio can help small-capital banks increase capital faster, thereby improving operational capacity and minimizing credit risks. Therefore, increasing the foreign ownership ratio in banks with small capital will reduce credit risk more strongly than in banks with large capital sources and sustainable development.

5. Conclusion and Policy Implications

5.1. Conclusion

The results imply that an increase in foreign ownership has an impact on reducing the credit risk of Vietnamese commercial banks. This result is consistent with the studies of Laeven (1999), Agoraki et al. (2011), and Ehsan and Javid (2018). The increase in foreign ownership ratio will have a greater effect on reducing credit risk for listed banks and banks with low equity ratios than for other banks.

In general, the research results of influencing factors are consistent with the research hypotheses. These hypotheses are developed based on relevant empirical studies and the current situation in Vietnam. Therefore, the research results of the authors for the case of 28 commercial banks in Vietnam in the period 2009–2020 will contribute to supporting the previous economic views. In addition, the research results also provide practical, reliable assessments of the relationship between foreign ownership and credit risk of Vietnamese banks in the context of joining the CPTPP.

5.2. Policy Implications

Joining the CPTPP Agreement is an important step in Vietnam's international economic integration process. The CPTPP Agreement will create favorable conditions for banks to access capital, technology, and professional management capacity brought by foreign investors, thereby reducing credit risk.

To achieve the best effect, it is necessary to have a strategy to manage foreign capital in the Vietnamese market. Specifically, the Government and the State Bank may consider flexibly adjusting the foreign ownership ratio according to the capital size and influence of each bank. For example, for a group of large-capital banks, the maximum foreign ownership ratio may be as low as 49%, while for a group of low-capital banks, it may exceed 51%. In the

context of increasing competition, this can help small banks raise capital faster, thereby improving operational capacity and reducing credit risks.

The increase in the foreign ownership ratio will have a stronger effect on reducing credit risk in banks already listed on the stock market. Therefore, when integrating into the world banking system as well as into the international monetary-financial market, banks themselves must actively improve their operations and become strong enough to meet the criteria for listing on the stock market and attract foreign investors.

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