

## Determinants of Individual Household's Lending to the Commercial Bank in Can Tho City of Viet Nam

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### Abstract

*This paper investigates the factors that are affected the savings decision of individual customers at commercial banks in the province of Can Tho city. Data used in the paper were gathered from a survey of individual households in the province of Can Tho city. The method used is a Double hurdle models which included a probit regression model and Tobit regression model. The findings show that factors affecting the savings decision, the amount of deposits are the educational levels, relatives working at the banks, the distance to the bank, income of individual households and interest rates. Based on research, this topic has proposed some solutions to help commercial banks exploit idle capital, expand customer network and improve the situation of raising capital in the province of Can Tho city.*

**Key words:** *savings, individual customers, commercial banks, Can Tho City.*

### 1. INTRODUCTION

Can Tho city is formed after three adjustments of administrative boundaries, undergoing 40 years of construction and development of Can tho city has reached various important achievements, quite comprehensive and initial developments;

Appearance, status, economic potential shifted dramatically across many fields, step-by-steps affirm the motivation role to promote the development of the Mekong Delta region, contributing to the importance of the industrified process, modernization of the country.

As with all other economic activities, Capital is quite significant for the Bank operation that is a key issue leading in the operation of the business. To create and maintain the mass of capital, the bank must have a reasonable capital exploitation strategy on the basis of the maximum use of positive factors and restrict the negative factors affecting on the bank's capital mobilization. The mobilization for idle money in population (mostly personal clients) is a viable measure to respond promptly to capital needs.

Beside the capital from the mother banks and other sources, attraction the capital from the individual households is also considered as huge sources for the commercial banks. The decision on lending of the households is either affected by the sensitive evaluation on the bank performance or the friends' introduction. On the other hand, the interest rate and other awards also play significant role. The capital of the banks in the state also made significant impact on the performance of the banking business. Therefore, it is meaningful to understand the psychological, the factors affecting the customers in lending money that is an important issue to exploit the customer market, effectively exploit the source of idle capital. Thus, analysing factors that influence the decision to send the savings of individual customers in commercial banks in Can Tho city is needed.

## **2. THEORETICAL FRAMEWORK**

### **2.1. A trade off theory of the household capital structure**

This part focuses on the tradeoff theories both on the firms and the households entities. Regarding to this theory, the firms

choose optimal debt level by weighing tax benefits if debt against costs of financial obstacles. The firm that pays interest on debt receives a proportional reduction in tax, namely tax shield. Then the firms will consequently borrow up the point where marginal tax shields become equal or less than possible financial costs of obstacles. Under this theory, taxes justify the existence of a proper level of debt and that safe firm relies more heavily on debt than on equity, contrarily to riskier firms with high intangible assets and high costs of financial obstacles. Various empirical research support the tradeoff theory and the existence of an optimal capital structure. However, other findings suggested that most of profitable firms within each industry are often the most conservative in terms of debts that are counterintuitive at the eyes of this theory.

Similarly to the firms, taxes are significant factor in household's financial decisions. The tax regime influences and creates patterns in what concerns assets portfolio, housing, and debt choices, among others (Poterba, 2002), although tax issue differs from country to country. Thus, a tax shield similar to the one produced for firms exist for households. Individuals have the incentive to enter debt contracts to take advantage of this lower taxation. Consequently, a similar discussion to the corporate capital structure theory can be developed for the hypothesis of families' seeking a specific capital structure target. In the study of Alessie et al (2002) suggested that Dutch households are, due to institutional information, and market factors, typically more sophisticated financially than other countries, such as Germany and Italy.

There are other motivations for the households to seek a specific debt target although the taxation discussion is very strong. Individuals, in the maximization of satisfaction of their needs, use personal finance devices to smooth consumption thought the years. They recognize their future stream of income, and enter debt contract that allow them to buy the assets that will assist them for long-run periods. Since a

tradeoff theory exists, now between the marginal benefit of acquiring an asset through debt today, and the financial obstacles cost that debt and interest repayment may cause in the future.

Several arguments for rationale of the convergence of debt levels towards an optimal debt target, specific to each household, exists, similarly to the behavior of firms predicted in the tradeoff capital structure theory.

## **2.2. A pecking order theory of household capital structure:**

This part presents the existence of a preference for fund sources by the households. The model used is inspired by the pecking order capital structure theory developed by the Myers (1984). Unlike the tradeoff theory, the pecking order theory does not recognize the existence of an optimal long run debt target. In this theory, debt changes are motivated by shortage of internal funds to finance firms' activities in the period. The periodical response to the need of funds controls capital structure, and not the convergence towards a perceived optimal debt level based on the balancing of tax advantages of debt, and possible financial obstacle costs, as in the tradeoff theory.

In this theory, a ranked preference for the instrument of external sources of funds exists because of asymmetric information, and signaling associated with these instruments. Firms prefer internal financing to external financing. But if external capital needs to be raised firms prefer debt to equity. As surplus funds exist, this surplus is used to repay debt prior to equity repurchases.

The financing decision process for households in each period is simpler than for firms. The choices made by the households in what concerns their capital structure cannot consider equity type of instruments, except in very specific situations such as marriage or inheritance. Therefore, a preference can only be established between internal funds such

as income generated in the period and wealth accumulated through time, and the available external sources of funds. For a household, a heavier debt load incurs direct and indirect costs. The primary cost is interest paid. In addition, the other less quantifiable costs may arise. Individuals, and consequently families are risk averse, and debt increases the chance of financial obstacles. In the presence of debt, a proportion of future income must be kept aside to repay capital and interest. This manage of income debt results possibly to un-flexible fund allocation in certain periods, as income may be only enough for daily households expenses and debt repayment. Problems can be more acute if interest repayment is variable. Then, debt is avoided, as free funds access may become impossible in distress periods.

Besides, other less obvious factors may clues the households to avoid debt contracts. Debt has attached a social cost. Highly indebted individuals are regarded by society as unsuccessful. These individuals have harder access to new debt than a non-debtor under the same circumstances, which diminishes financial suppleness. This fact results again to higher chance of financial obstacles in possible financially critical periods.

Similar to firms' case, because of direct and indirect costs of debt, a pecking order theory for the households would adopt internal fund as preferable to external sources, represented by debt. The households would primarily exhaust their internally available funds, and only in deficit periods would enter debt contracts to finance the deficit.

In what concerns debtor households with a surplus of funds, such as where internal funds exceed expenditure, debt repayment may be optimal. As discussed previously, debt has several types of costs. Then, unless the expected return from the investment of the excess funds for the period of exceeds the interest paid in a level that compensates for the risk aversion of the individuals and the social costs of debt, debt repayment

would be expected in surplus of funds situations. As a result, in the analogy to corporate capital structure theory, a household capital structure can be constructed.

### **2.3. Previous studies**

Various studies on the determinants of lending decision of the people to the banks were conducted. The findings that the prestige of banks, the availability, the bank officers are affecting on the lender's decision. However, the level of each factors are not quite similar as presented in previous studies.

Firstly, in a cross national study of students bank selection criteria in developed and developing countries, Blankson et.al.(2009) identified four key factors - convenience, competence, recommendation by parents, and free banking and/or no bank charges - to be consistent across the two economies. The recommendation of the study is that in the context of an open and liberalized market environment, retail bank marketing strategies should be standardized irrespective of the national development stage. It concludes that retail bank managers particularly in developing countries should learn to provide consistent and good customer care.

Secondly, Aish et al., (2003) compared the bank selection decisions of the small business market across UK and Egypt. The results reported show various similarities and deliver evidence to suggest that brand plays major role in the bank selection decisions of the small businesses at both UK and Egypt .The study supports the opinion that technical quality (quality of service itself) is more important than functional quality (quality of the service provider) in bank selection decisions. More specifically both Egyptian and UK small business customers consider financial items (fees, interest rates and credit availability) as the most important factors in bank selection decisions. For Indian, Kamakodi and Khan (2008) surveyed and obtained responses from 292 banks customers on the factors that influence the bank selection decisions. The top

10 parameters based on importance are found as Safety of Funds, secured ATMs, ATMs availability, reputation, personal attention, pleasing manners, confidentiality, and closeness to work, timely service and friendly staff willing to work.

Thirdly, Shevlin and Graeber (2001) explored the various factor the influence a customer in choosing a particular bank in Texas, USA. They pointed out that ATM (Automatic Teller Machine) was the primary reason for a customer choice for a bank and further branch visit and referral from friends and relatives are most prevalent sources of influence. Devlin (2002) analyzed the customer choice criteria in retail banking market in the UK on the potential variations in the importance of various choice criteria, which were classified as either intrinsic or extrinsic, with respect to customer financial knowledge. Intrinsic attributes were defined as those specific to a particular service rather than generalizable across services like price and service specific features. Extrinsic attributes were those factors that are not specific to a particular service and can be generalized across offering like service quality factors, corporate brand and relationship factors. It was found that lower knowledgeable groups were particularly influenced by extrinsic criteria of location of the branch and recommendations that they receive. Even though such extrinsic factors were found to influence higher financial knowledgeable groups also, higher knowledgeable groups were found more likely to take account of intrinsic attributes such as service features, rate of return and low fees in their choice.

Lastly, Mylonakis et al., (1998) concluded that the most important bank selections criteria are convenience, bank reputations, quality of products and services, interest rates and fees, education and personnel contacts, facilities, branch environment, services and after service satisfaction. Their research on bank customers of Greece showed that bank selection criteria like location-convenience, quality of service (attention to the customer, personalized service, no queues)

seen to influence the bank selection and factors like advertising did not seem to influence bank customers at all. Chen (1999) conducted a survey of 336 domestic-owned and 39 foreign owned banks in Taiwan in 1997 to identify critical success factors adopting various business strategies in the banking sector. Data was analyzed using factor analysis technique which highlighted four factors, namely the ability of the bank to manage operations, bank marketing, developing bank trademarks and financial market management. Phuong and Har (2000) under took a study of bank selection decisions in Singapore using the Analytical Hierarchy Process (AHP) through a study of banking preferences of college students. The findings indicated that the most important criteria affecting undergraduates' bank selection decisions are higher interest rate for saving, convenient location and overall quality of service. They are followed by the availability of self-bank facilities, charges on services provided by banks, low interest rate on loans, long operating hours, availability of students privileges and recommendations by friends and parents specifically. The respondents considered overall quality of service more than twice as important as recommendations by parents/friends. Colgate and Hedge (2001) studied the process of defection in Australia and New Zealand through a mail survey. The study indicated three main problem areas, which influenced customers to switch banks, namely service failures, pricing problems and denied services. This finding is important in our context of study because, a client may switch to another bank because his present banker may not provide a service, which the customer thinks most important. They further add that customers tend to complain more often about services failure prior to exiting a bank and customers may be staying silent about the problems that are most important in their decision to exit the bank.



### **3. DATA AND METHODOLOGY**

#### **3.1. Data:**

Data used in this paper come from two type of sources. A secondary data is obtained from the reports of commercial banks in the Can Tho city of Vietnam. Primary data is obtained from the questionnaire by interviewing directly 200 individual household in three districts, namely Cai Rang, Binh Thuy and O Mon of Can Tho city, Vietnam.

#### **3.2. Methodology:**

This paper also uses a Double Hurdle Models (DHM) formulated by Cragg (1971) assuming that the individual (or households) make two decisions concerning the borrowing. Each decision stage is determined by a different set of factors. According to the behavioral content of this model, two separate hurdles must be passed before a positive loan size can be obtained. The first hurdle involves decision about whether or not to save credit (saving decision). It is reasonable to assume that the choice of lending decision to credit, like the decision to smoke, is an economic decision and is influenced by social and demographic issues (Blaylock and Blisard, 1993). The second hurdle concerns on the level of loan saved by the households that may be affected by various factors related to households as well as financial institution's characteristics. The two decisions can be regressed as dependent on or independent of each other. According to Lee and Maddala (1985), the two decisions have been modeled as sequential.

Formally, following Jones (1989) and Pudney (1989), the double hurdle model can be specified as follows:

$$\text{Observed loan size: } Y = d \cdot Y^{**} \quad (1)$$

$$\text{Loan participation: } W = \alpha'Z + u \quad (u \in N(0,1)) \quad (2)$$

$d = 1$  if  $W > 0$  and  $0$  otherwise.

$$\text{Loan size equation: } Y^* = \beta'X + v \quad (v \in N(0, \delta^2)) \quad (3)$$

$Y^{**} = Y^*$  if  $Y^* > 0$  and  $0$  otherwise.

Where  $W$  is defined whether the households decide to save credit,  $Y^*$  is latent variable showing households' loan amount lend,  $Y$  is the observed dependent variables (the amount of money the household save),  $Z$  is a vector of variables explaining the credit saving decision,  $X$  is a vector of variables determining on the credit amount,  $u$  and  $v$  are the corresponding error terms assumed to be independent and distributed as  $u \in N(0,1)$  and  $v \in N(0,\delta^2)$ . The independence of the error terms is a common assumption in these type of models (Jensen and Yen, 1996; Su and Yen, 1996).

Assuming that the error terms  $u$  and  $v$  are independent, the model can be assigned to follow Cragg model (Cragg, 1971) in which zero loan amount has subscript  $p$ , positive loan amount is shown by a subscript  $+$ .

$$L = \Pi_0 [1 - p(v > -\alpha Z)] p(u > -\beta X) \Pi + p(u > -\beta'X) f(y | u > -\beta'X)$$

The Cragg model is a two-step approach with a probit model for probability of saving decision in the first stage and truncated normal regression in the second stage.

An alternative assumption is to hypothesize that the error terms of the participation and loan amount equations are correlated, and that the participation decision dominates the loan amount equation. Jones (1989) refers to this case as a first hurdle dominance. The model implies that observed zero loan amounts are the result of saving decisions only and that once the first hurdle is passed censoring is no longer appropriate. This suggests that only individual households with positive loan amount are included in the loan amount equation.

**Table 1: Specification variables in the models**

Variables	Explanation
Y	Whether the individual households has decision to save to commercial banks which takes the value of 1 if the households decide to save the loan, 0 otherwise.
X <sub>1</sub>	Interest rates which take the value of 1 if the individual households evaluate the attractive interest rates, 0 otherwise.
X <sub>2</sub>	Income of the households (Billion VND/Month)
X <sub>3</sub>	Households that has members working for the banks receives value of 1, 0 otherwise.
X <sub>4</sub>	Gender of the individual households which takes value of 1 if the household's respondent is man, and 0 for woman.
X <sub>5</sub>	Educational level of households' head which takes value 1 if the households' head is a men, and 0 otherwise (Years)
X <sub>6</sub>	Age squared which is the age squared of households' head (Years)
X <sub>7</sub>	Distance from their houses to the banks (kilomet)
X <sub>8</sub>	Job of the households' head which takes value f 1 if the household are currently working for the office, 0 for othwerwise.
X <sub>9</sub>	Expenses of the households (Billion VND/month)

## 4. RESULTS AND DISCUSSION

### 4.1. Descriptive statistics on the variables

Tables 2 compare the household characteristics of savers and non-savers. Households having decision to lend a loan (122 households, 61%) are relatively higher than those had not (78 households, 39%). In terms of education, non-savers had on average a lower educational level than the individual-savers. Most of the savers had completed at least nine years of schooling. Among 200 observations, 101 responseance are the man and the rest belongs to women. Particularly, men and women savers account for 2/3 of their proportion in the samples meaning that there is no statistical significant difference between man and woman in saving decision to the bank in surveyed locations. Regarding to the age, the average age of responseances in the study is about 39, minimum of 21 and maximum of 66 years of ages. In fact, higher years of age of the households' head are more likely to use for the future activities, thus higher propability of lending decision can be obtained.

It is furthermore hypothesized that if the household head has any social and/or political position in the banks, he or she may have a high probability of saving the load to commercial banks and would be less likely to lend to the informal sector. According to educational level, most of lenders to commercial banks in Can Tho city are certainly reaching the high school level with the average year of schooling of 14 years. In fact, the lenders with higher educational level is hypothesized that they may have higher income and are actively in searching loan information from the market in the case of needs. More banking information they have, more opportunities for them to save. In the sample, there are 68% of respondents not coming from the officer groups which may have more surplus funds availability for saving.

#### **4.2. Determinants of individual households' lending to commercial bank in Can Tho city of Vietnam.**

**Table 2: Determinants of lending decision by individual households**

Variables	dF/dx	Coefficients	z- value
Gender	-0,0607	-0,1625	-0,78
Age <sup>2</sup>	0,0000	0,0001	0,39
Job of households	-0,0488	-0,1293	-0,51
Educational level	0,0509	0,1360	3,81***
Income of households	2.30e-08	6,14e-08	1,68*
Interest rate	0,1427	0,3782	1,79*
Distance to the bank	0,0571	0,1528	2,06**
Relatives working at the banks	0,2594	0,6874	3,31***
Constant		-2,7887	-4,97
Observations			200
Chi squared			61,87
Probability > Chi squared			0,0000
R <sup>2</sup>			0,2313
Log-likelihood			-102,8166

*Source: Estimated by the author on Stata software; \*, \*\*, \*\*\*: Significant level at 10%, 5%, 1%*

Firstly, the educational level is statistically significant at 1% affecting on whether to lend savings of individual customers

meaning that the probability to lend the money to the banks will increase 5.09% as the educational level of the households' head increases in 1 year of schoolings. This variable is positively correlated with dependent variable implying that the higher the level of study, the better the customer needs to send more savings. As a result of the higher educational level customers, the ability to compute investment is more efficient and the ability to bring income is also higher, so the decision to send savings is also increased. The result is similar to the study of Truong Dong Loc and Pham Ke Anh (2012) and Nguyen Quoc Nghi (2011).

In addition, the saving decision of individual households is also statistical significant affected by the having a relative in the banks at 1% level. This means that if the individual households who have relative's working at the banks can increase their lending possibility up to 25.94%, *certeris paribus*. In fact, currently, various the scams and phishing arised from the customers without loan information are significantly affecting on the customers' belief. Besides, the customers are also afraid of the asymmetric information from the mergers, acquisition and bankruptcy. Thus, having relatives working at the commercial banks may help the customer more confidence on their saving process. Thus the results of the same study as the Truong Dong Loc and Pham Ke Anh (2012), Shevlin and Graeber (2001), and Mylonakis et al., (1998).

Furthermore, the saving decision of individual households is positive statistical significantly influenced at 5% of distance from their home to the banks. The findings indicates that, *certeris paribus*, the distance from the individual households to the bank increases one kilomet, the probability of their lending decision will decrease 0,1528%. This confirmed for the studies of Truong Dong Loc and Pham Ke Anh (2012), Shevlin and Graeber (2001), and Mylonakis et al., (1998).

Thirdly, Income variable are statistically significant affecting on the saving decision of individual households at

10%. The positive coefficient correlation defines that the higher income households may lead to higher probability to save money to the commercial banks at Can Tho city of Vietnam. In fact that due the rapid change in the economics, the individual households who have surplus money may face difficulty to get other investment channel rather than saving to the banks. The findings confirmed for previous studies of Blankson et.al.(2009), Shevlin and Graeber (2001), and Mylonakis et al., (1998).

The interest rate variable is a dummy variable (a value of 1 if the customer feels the bank's interest rate is attractive, getting value 0 if the customer is given an unattractive interest rate) statistically significant at 10% with the original coefficient of 0.3782. Interest rate factors affecting 14.27% to the decision to lend the savings of individual clients. The findings implies that if the interest rate rises up the customer will want to lend savings on more commercial banks. However, in fact, as the interest rate is fluctuated rapidly, it is significant for the customers to look for the highest interest rate place for lending. This finding confirms for the studies of Truong Dong Loc and Pham Ke Anh (2012), Aish et al., (2003), Shevlin and Graeber (2001), and Mylonakis et al., (1998).

#### **4.3. Factors affecting on the loan size lend by the individual households**

The result of the Tobit model in table 3, indicating that the age of the individual customer is correlated with the saved money amount at the commercial banks. The correlation coefficient between age factors and the amount of savings of individual customers is 0.0003 implies that as the age of the customers increase 1 year of age, the amount of deposit they send to the commercial bank will increase to 0.03 billion VND, ceteris paribus. The result is similar to the research of Shevlin and Graeber (2001), and Mylonakis et al., (1998).

**Table 3: The estimated result of Tobit model on loan size**

Variables	dy/dx	Coefficients	t-value
Gender	-0,0876	-0,0876	-0,53
Age <sup>2</sup>	0,0003	0,0003	2,78***
Job of households	0,1138	0,1138	0,53
Educational level	0,0235	0,0235	0,71
Income of households	0,8744	0,8744	4,19***
Interest rate	0,5671	0,5671	3,23***
Distance to the bank	0,0117	0,0117	0,34
Relatives working at the banks	0,4547	0,4547	2,45**
Constant		2,3254	0,75
Observations			122
Chi squared			54,54
Prob> Chi squared			0,0000
R <sup>2</sup>			0,1486
Log-Likelihood			-156,2108

Source: Estimated by the author on Stata software; \*, \*\*, \*\*\*: Significant level at 10%, 5%, 1%

Secondly, Income variable are statistically significant affecting on the loan amount by the individual households at 1%. The positive coefficient correlation defines that the higher income households may lead to higher loan amount to lend to the commercial banks at Can Tho city of Vietnam. The findings confirmed for previous studies of Blankson et.al.(2009), Shevlin and Graeber (2001), and Mylonakis et al., (1998).

Thirdly, the interest rate variable is statistically significant affecting on the loan amount offered by the individual households at 1%. Interest rate factors affecting 0.5671 to the loan amount lendings by of individual clients. The findings implies that if the interest rate rises up the customer will want to lend savings more. This finding confirms for the studies of Aish et al., (2003), Shevlin and Graeber (2001), and Mylonakis et al., (1998), and Truong Dong Loc and Pham Ke Anh (2012).

Lastly, the loan amount of individual households is also statistical significant affected by the having a relative in the banks at 5% level. This means that if the individual households who have relative's working at the banks can increase their

loan amount up 0.4567 billion VND, *certeris paribus*. Thus the results of the same study as the Shevlin and Graeber (2001), and Mylonakis et al., (1998).

## **V. CONCLUSIONS AND RECOMMENDATIONS**

### **5.1. Conclusions**

The article "determinants of individual household saving to commercial bank in Can Tho City" helps to analyze the factors affecting the decision to save and the amount of customer's savings deposit at commercial banks, indicating the impact of each factor affecting the decision to lend money and the amount of individual customers. The research results show that, despite the income and the ability to accumulate people growing, however the percentage of people with savings are still yet high. These are because of low interest rates, cumbersome procedures, without credit services information. Also, people still prefer the habit of keeping money at home and are prone to attraction by other investment channels such as buying gold, buying land, playing, and lending,... that have yet to notice the benefits of sending savings.

The research illustrates the status of savings deposits from individual customers as well as to look into the factors affecting the decision to send savings and amount of money deposited at commercial banks in the city of Can Tho these are variable interest rate, average household income, households having relatives working at the bank and the average age of individual households. The following are a few recommendations to be able to further promote the work of the savings of commercial banks in the city of Can tho in particular and Vietnam in general.



## **5.2. Recommendations**

### **5.2.1 Vietnamese State Bank**

The State Bank is the central bank of the financial institutions where the national monetary policy promulges. Since the stable monetary policy is likely obtained the households can be assured of sending money to the bank without sacrificing price. Furthermore, the commercial banks are easier to operate in their business. Therefore, the State bank should have monetary policy tailored to each stage specifically.

- Manage the flexible weather in the earthly rate of mobilizing so that the banks can appeal and attract people to deposit more savings.
- Facilitate the linking, cooperation between banks together that can result of the bridge between the commercial banks with domestic and foreign organizations, aimed at finishing over banking technology, banks together development, providing the best service to clients.

### **5.2.2. Department of Taxations**

- Issue the appropriate tax policy to create a favorable environment for economic components developed through microfinance policies, in the framework of the law of good and services because the development of the bank is associated with the existence and development of the economy.
- Regulate the administrative reform, simplify the procedures, update timely information, regularly organizing seminars for training, troubleshoot to help people as well as general credit institutions and commercial banks autonomously and well-being in economic development, contribute to improving income, improves people's lives as well as the development of Vietnam's economy.

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