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State Bank of Vietnam

Microfinance in Vietnam: A Survey of Schemes and Issues

By

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The Masters in Development Economics (MDE) Team, now formally known as Mekong Economics Ltd., were the contracted consultants for this report. The MDE Team draws its experts primarily from teachers and alumni on the MDE teaching programme <http://welcome.to/neu-iss>.

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Preface

This report is the synthesis of a series of outputs produced by the Masters in Development Economics (MDE) Team (now *Mekong Economics Ltd.*) for this DFID/SBV assignment. The attached CD-ROM contains the full documentation and database of the survey. In addition to this report, it includes the three working papers about “lessons learned”, “the institutional environment”, and “sustainability case studies”. There is also a Word database that summaries each microfinance scheme on one page, and a copy of the workshop powerpoint presentation. The full database is there and can be easily searched. These documents can also be downloaded from vnmicrofinance@yahoo.com (using the password “DFIDsbv”).

The timeline of about six weeks to design and implement the survey was very tight. Only a few days were possible for design and review of the questionnaire. Without pilot testing, problems were expected. A list of known microfinance schemes and organisation contact details was built up from the start. We apologise to the few schemes that “escaped the net”. Data entry was conducted as carefully as possible. Questionable numbers were checked with the hard copies and by ringing the organisations. Data cleaning was conducted, despite time constraints. No doubt data errors remain.

Including state organisations was a particular challenge, requiring letters of introduction, and then arranging permissions and the delegation of tasks from the senior management. In the end, many schemes from the Vietnam Bank for Agriculture and Rural Development (VBARD) and the Vietnam Bank for the Poor (VBP) were included. The main lending of the VBARD and VBP was not included in time due, apparently, to confusion concerning the definition of “microfinance schemes”, which these organisations interpreted as meaning subsidised lending or special schemes. This suggests a possible conceptual divide between “real banking” and “microfinance” that was also at times also evident with some NGOs. The Ministry of Labour, Invalids, and Social Affairs was also only partially covered, although most of their activity involves direct transfers or lending to small businesses to “create employment” rather than to households as such. No doubt the database could be developed to become more comprehensive, but it is sufficient for present analytical purposes. The desirability of improving and updating this database as an activity under a revived “microfinance forum” is discussed towards the end of this report.

The MDE Team members were Adam McCarty (Team Leader), Dr. Tran Tho Dat, Lee-Anne Moloney, Le Thanh Tam, Tran Quang Chung, Nguyen thi Thu Ha, Nguyen thi Hai Yen, and Dinh thi Thu Huong. In addition, Alan Johnson, Dang Ngoc Quang, Bob Baulch, William Smith, Charles Nicholson and Michael Marx provided comments on the first draft. Many of these comments have been incorporated to finalise this report. The views and arguments expressed in this paper, however, remain those of the author and are not necessarily those of DFID or the State Bank.

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Background and Objectives of the Microfinance Survey

This report follows up on a 1996 UNDP survey of microfinance activity in Vietnam. That 1996 survey covered 60 foreign NGO and donor schemes, examining ten in depth. The report included the following main conclusions about the schemes:

- Existing schemes are effective in reaching the poor, and are popular and well managed.
- Many schemes promote and disseminate research to understand “best practice” and for advocacy.
- Few schemes, however, operated sustainably or paid much attention to mobilising savings.

Broader policy conclusions included:

- There is large untapped demand for financial services tailored to the needs of the poor.
- Savings and credit groups are an effective means of involving the poor.
- The poor are capable of taking and repaying loans at sustainable interest rates.
- The poor value access to credit more than the low cost of credit.
- The poor can save and value safe and accessible facilities.

Five years later, DFID and the State Bank of Vietnam (SBV) decided that a new survey of microfinance in Vietnam was needed¹. The need was not simply because of the time lapse, but also because the larger multi-lateral donors were showing greater interest in funding microfinance activity, and it was therefore a good time to survey the sector and identify strategic issues and “lessons learned” for their benefit.

The working definition of microfinance schemes for this report includes “all small-scale formal and quasi-formal financial lending to, and savings from, rural households, directly or through groups”. This definition excludes direct income transfers to households, such as pensions and some Ministry of Labour, Invalids, and Social Affairs (MOLISA) schemes. International studies often include insurance as “microfinance”, but that service is yet to emerge in any meaningful form in rural Vietnam and it has therefore been excluded from the working definition. The choice of rural areas only is really one of convenience, as time and other limitations prevented coverage of the complex urban areas and the many commercial banks. Urban microfinance probably warrants its own study. Informal lending is also excluded, partly due to data problems, but also because a long-term objective of this research is to contribute to sustained development of formal sector microfinance.

¹ Another previous survey was *The Savings and Credit Forum of Vietnam* (1995), and other research analysing microfinance in Vietnam include Robinson (1996), UNDP (1996b), Hideto Sato (1997), Hung (1997), and MRDP (1998a,b).

The What and Why of Microfinance

What is microfinance? Why are sustainable microfinance schemes needed? And what does microfinance in Vietnam need – more funds, a better legal framework, coordination, sustainability?

Microfinance is small-scale lending to, and saving from households, and for this report the focus is on rural households. But the edges of this definition are far from precise. What is “small scale”? Why does excluding urban households seem reasonable? The answer is because “microfinance” is a concept that defines a type of lending which is different from “normal” commercial lending. The difference to many people is in its nature of helping poor households (which are mostly rural), and thus it gets mixed with opinions about social policies and income distribution. Many people argue that microfinance should therefore be available at less-than-market interest rates. This is a mistake. Mixing access to finance with charity leads to problems of credit rationing, corruption, and unsustainability. Better to keep them apart. Give charity, conduct business.

The Vietnamese microfinance market is segmented. That is, it is several markets, with some overlap. Probably the most useful breakdown is to divide households into those who can access the Vietnam Bank for Agriculture (VBARD) and those who cannot. The poor are mostly excluded from the attractive formal market of the VBARD. Aside from what may be once-off “loans” from the Vietnam Bank for the Poor (VBP), poor households must turn to relatives or private lenders for loans. For the poor, widespread and regular access to loans at interest rates somewhat below private lenders would be of great value. In Vietnam, some providers of microfinance have failed to provide this service because, trapped in a microfinance-as-charity vision, their small schemes can grow only with proportionate increases in subsidies. In such cases, a very small percentage of the poor get cheap credit, while the remainder is left to deal with moneylenders.

Microfinance in Vietnam needs and deserves great assistance. Expansion of existing schemes offering cheap credit would require vast funds. More realistically, experimenting with and expanding sustainable schemes is important. Coordination and the exchange of ideas and experiences can help identify what works best in Vietnam. Making a scheme truly sustainable is a much more difficult business than setting up and running a subsidised scheme. Expansion, however, can be constrained by the legal status and regulatory environment for such schemes. Thus it is all needed: funds, a microfinance-as-business vision, and a supporting legal framework.

The Main Arguments & Findings of the Study

Microfinance as a donor activity is different. Most notably because a successful project never closes, despite the earnest desire of some donors to do so and move on with disbursements! A financially sustainable scheme could even grow of its own accord in line with demand. Others, close to sustainability, can maintain their real level of activity through modest ongoing subsidies (e.g. to administration and training). Most, however, slowly wind down. But it can take many years. For many donors, a microfinance project “closes” by “handing over to local authorities” the job of managing a steadily diminishing fund, where lending costs and defaults always outweigh revenues.

The “success” and impact of a scheme should be judged upon the welfare impact (household living standards) of donor spending over a long time period². A scheme that maintains itself or even grows over the period is going to score much better than one that fades away, even if the interest rate had been lower for the short-run scheme. Although at a higher “price of funds”, the sustainable scheme would have created vastly more lending. One problem, however, is that most donor microfinance schemes are integrated with other activities, which makes their evaluation more complex and arguments for subsidised microfinance schemes often more reasonable.

Donor spending on microfinance is only a minor share of all donor spending and of all rural microfinance. Given the direct poverty alleviation impact that many schemes seem to have shown, it arguably deserves a larger share of donor funding. The small volume of donor funding is also spread over many schemes and organisations. Microfinance has largely been left to the NGO community³ and some bilateral donors, although multilaterals are now paying more attention to the area. Because they are such small players, the NGOs should carve themselves an important role to pilot test novel ways of designing and implementing schemes. Leading by example, they can try different models in different regions. Some have done this, although most have chosen to adopt “tried and tested” models with little variation.

NGOs have tended to focus on maximising their impact in the geographic areas that they have chosen, and to accept the various institutional constraints they find as given. There is a need to “lift the vision” of NGOs towards thinking about how their schemes can contribute to the overall development of microfinance and poverty alleviation in Vietnam. Innovative experiments can test a good idea that can spread. Better coordination can help spread those ideas, and it can organise all the small players into a single stronger voice to push for institutional and legal changes.

² Measuring the impact of a scheme requires comparison to a “control group” throughout the time period. Few schemes do this. The need for more sophisticated impact evaluations is discussed below.

³ Vietnamese NGOS are active in microfinance, and some were covered by this survey, but they are few and small. Thus “NGO” in this report refers almost exclusively to international NGOs.

Microfinance in Vietnam

Who owes who, 1992-1998

Data from the 1992-93 Vietnam Livings Standards Survey (VLSS1), showed that 47 percent of rural households and 38 percent of urban households were in debt. Poor households were slightly more likely to be in debt in rural areas, and much more likely to be in urban areas: 50 percent of rural and urban households in the lowest expenditure quintile were in debt. By 1997-98, the percentage of households in debt had risen to 50 percent (54 percent of rural households).

In 1992-93, private moneylenders and individuals provided 73 percent of loan funds in rural areas, and government banks 23 percent. By 1997-98, the share of government banks had increased to 40 percent (Table 1), and the share of money-lenders had fallen from 33 percent in 1992-93 to 10 percent in 1997-98. This reflected the rapid growth of VBARD lending and a “crowding out” of the informal sector.

Table 1: Rural household loans and average loan sizes by sources

| | <i>Loans</i> | | <i>Average loan size</i> |
|---|------------------|------------------|--------------------------|
| | <i>(percent)</i> | <i>(percent)</i> | <i>(1,000 dong)</i> |
| <i>Total</i> | 100 | | |
| <i>Informal financial sector</i> | 51 | 100.0 | 1,752 |
| 1. Money lenders | 9.8 | 19 | 2,141 |
| 2. Relatives | 24.2 | 48 | 1,861 |
| 3. ROSCA and other individuals | 16.8 | 33 | 1,366 |
| <i>Formal & semi-formal financial sector</i> | 49 | 100.0 | 3,209 |
| 4. Private banks and cooperatives | 2.2 | 4.4 | 2,230 |
| 5. Government banks | 40 | 82.2 | 3,512 |
| 6. Government programs and others | 7.7 | 13.4 | 1,547 |

Source: Vietnam Living Standard Survey, 1997-1998

The extension of the formal banking system to rural Vietnam is the most remarkable achievement of microfinance in Vietnam since 1996. Rural households are more likely to be borrowing from banks than urban households. In 1997-98, 7 percent of rural households had outstanding loans from the VBP (urban 4 percent), and 26 percent had loans from other government banks (urban 9 percent). Only 7 percent of rural households reported loans from private moneylenders, although 25 percent said they had loans from relatives and other individuals.

It seems possible that the volume of government funds going to rural areas has increased faster than the rise in demand due to increased living standards. The persistence of money lending at high interest rates does, however, suggest ongoing market segmentation – either by location (isolation), income groups (those without collateral), or institutional arrangements (e.g. cheap loans only for particular purposes). This hypothesis is discussed in more detail below.

Organisations and market structure

The role of the State

In 1999, as much as 5.9 million households had access to formal financial institutions, of which 2.7 million households were poor and low-income households (Dao Van Hung, 1999). The VBARD dominates formal sector lending in rural Vietnam. It reportedly lent to 33 percent of rural households in 1998, with the VBP lending to 11 percent. (For a more detailed overview of “organisations and market structure”, see appendix to this report).

After six years, the VBARD has expanded rapidly to 1,271 branches in 1998. The VBARD has switched from corporate sector lending to lending mainly to the household sector. In 1998, as much as 63 percent of outstanding loan funds were to households.

According to the Bank’s definition, a small loan is less than 5 million VND. A report about nine provincial branches showed that almost half of bank loan funds went to loans of over 5 million dong, although 16 percent of its customers were getting loans of only up to one million dong. The VBARD does not seem to be excluding credit-worthy poor households (i.e. those with asset collateral). The lending interest rate for VBARD is normally 1.0 percent/month (1.05 percent/month on long term loans).

The VBP lends directly to the poor. Up to the end of 1999, over 2.3 million poor households obtained loans from the VBP with total loan amount of 3,879 billion VND (276 million US dollar)⁴. The maximum loan term is 36 months, and the maximum loan limit is 2.5 million VND (170 USD). The interest rate of loans has been held at 0.7 percent per month.

The non-VBARD/VBP sector

Informal sector lending, as Table 1 showed, remains of great importance in rural Vietnam. Informal lending includes group lending, and a more structured form of this has emerged as People’s Credit Funds (PCFs) in recent years. There are also experiments with joint-stock banks and foreign NGO schemes, but the scale of these remains small. Finally, there are various government subsidised lending schemes targeted for specific purposes (e.g. reforestation, or “creating employment”). Vietnamese and foreign NGO schemes may be regarded as “quasi-formal” in that their status as lending organisations remains unclear.

The informal financial network providing credit to households includes:

- Private moneylenders
- Relatives, friends and neighbors (often without interest)
- *Ho/Hui*, which are local rotating savings and credit associations (ROSCA)

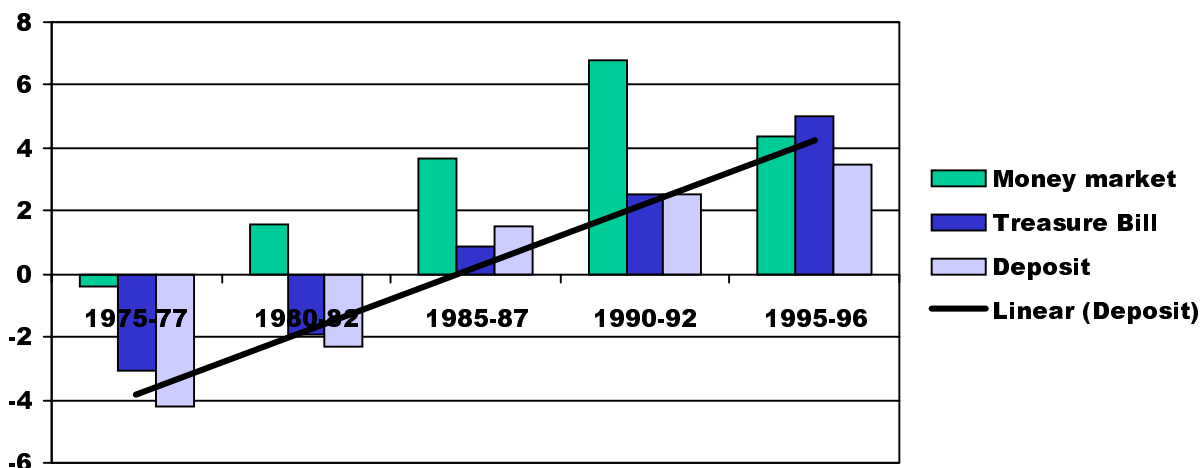
Vietnamese rural microfinance therefore remains dominated by the two big state banks. The lending interest rate charged by these banks is only weakly responsive to demand and supply conditions, and hence may be causing market segmentation and a repressed financial system in rural Vietnam.

⁴ Exchange rate is 14 500 VND/1 USD

Is rural microfinance a “repressed financial system”?

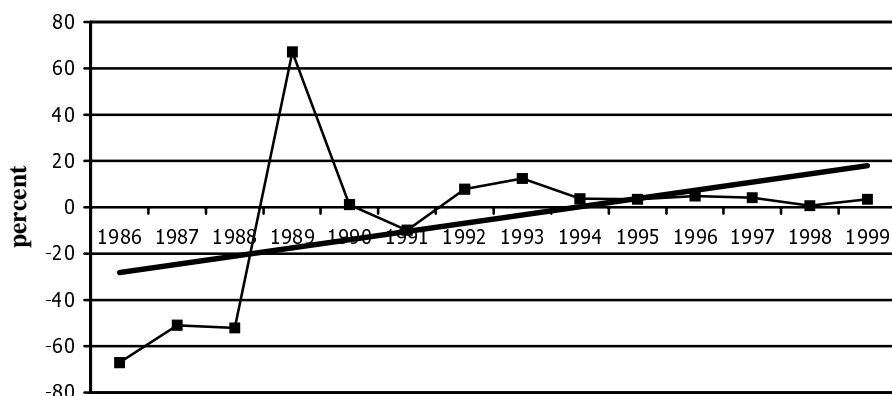
A “repressed financial system” is one where the government sets the interest rate and it is at a level below what market demand and supply would otherwise decide. In such systems, inflation is often greater than the set interest rates, leading to negative real interest rates. Figures 1 and 2 show the policy trend away from these systems, both worldwide and in Vietnam, during the past 20 years.

Figure 1: The international trend away from repressed financial systems
(Median ex-post real interest rates in developing countries: 1970s to 1990s)



Source: Honohan, Patrick (1999).

Figure 2: The trend in Vietnam away from a repressed financial system
[Real three-month deposit annual interest rate, 1986-1999, (%)]

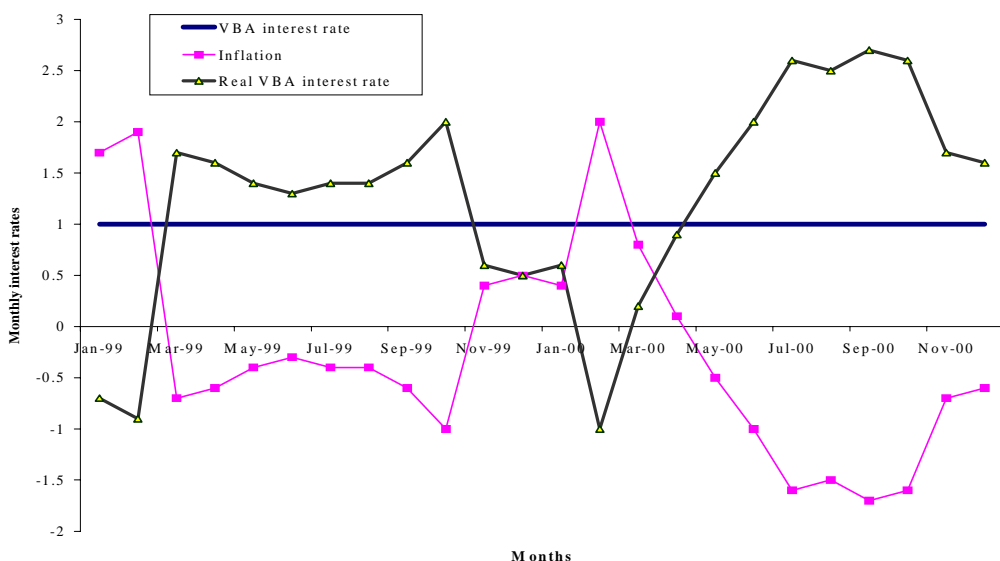


Source: World Bank (2000d)

The lending interest rate for formal sector lending in Vietnam is set by the government (and followed by most NGO schemes). But it is not obvious that this dominant nominal lending

interest rate (1 percent per month) is below what a free market would decide. The VBARD rate was 1.4 percent per month some years ago. But it has gone down as inflation has fallen (Figure 3).

Figure 3: Real and nominal VBARD monthly lending interest rates, 1999-2000



Source: World Bank <http://www.worldbank.org.vn/econdev/appet61a.htm> for 1999 data, and *Vietnam Economic Times*, Feb. 2001 for year 2000 data (p.28).

The real interest rate (i.e. the nominal minus the inflation rate⁵) has, however, risen. Inflation in Vietnam has actually been deflation (falling price levels) for most of the past 18 months. Between September 1999 and December 2000, deflation was recorded in ten months, and in September 2000 the VBARD real interest rate was a very healthy 2.7 percent (see Figure 3 above).

Consequently, nominal returns to the VBARD for lending during 1999-2000 were 27 percent (1 percent per month compounded), and real returns, due to deflation, were 34 percent. A bank should probably be profitable operating on a real return of over 15 percent per annum, given a much lower cost of funds and a low level of bad debts. But of course this has not been the return before 1999. Inflation ranged from 3 to 8 percent during 1995-98, and real VBARD returns on lending were below 10 percent annually.

The important policy objective for sustainability is to target a specific real interest rate that covers all costs, including cost of all sources of funds, and to then adjust the nominal rate on a regular basis in line with inflation. This is the policy of the all four big state commercial

⁵ Inflation here refers to changes in the Vietnamese Retail Price Index, but use of a food price index or some rural areas price index would be more appropriate for developing a more sophisticated methodology for setting microfinance scheme interest rates. The index fall is driven by the falling price for rice, which went down from 3,500 dong/kilo in December 1999 to 2,990 dong/kilo in December 2000, while prices for meat and petrol remained mostly unchanged.

banks in Vietnam, although the VBARD (and hence NGOs) does so much less actively, and in all cases the spread between the savings and lending interest rates is very small.

Formal rural lending in Vietnam is therefore at positive real interest rates, but are these rates below what a free market would determine? Money can be thought of as a commodity just like any other, with buyers and sellers. When government sets the price (in this case the interest rate), the mechanism of price “signals” to balance supply and demand cannot work. For this reason we can only guess at what the real competitive market interest rate would be in Vietnam, although we can examine indicators to show that it would be higher than the VBARD rate. First, however, we might ask ourselves what is the problem with a low government interest rate?

When the government sets a low price, demand for loans exceeds supply. Who will get a loan when many people want one? How to decide who gets a “ration” of cheap credit? In this case, government banks can choose the least risky borrowers, such as those with good collateral. But sometimes “rationing” decisions are more based on who has the best personal contacts. They would also have a preference to give larger loans, which cuts down administration costs. Some borrowers might offer bribes to get some of the “cheap money”. Poor households generally do not get loans.

A repressed financial system leads to a segmentation of the finance market. As discussed above, in rural Vietnam this is best looked at as those with or without access to VBARD loans. If this is the case, to what extent does the VBARD meet the large demand due to the low price? How big is the second non-VBARD market and who is pushed into it?

The government supply of funds is substantial

In 1999, 5.9 million households had access to formal financial institutions (Dao V.H: 1999). That is about half of all rural households in Vietnam (Box 1). Reported VBARD lending in 1999 was 20,362 billion dong (about US\$1.4 billion) to 4 million households at about 5 million dong each. VBP lending in 1999 was 3,897 billion dong (\$269 million) to 1 million households at about 1.6 million dong each. Including other government schemes, total government lending to rural households in 1999 was probably about \$1.9 billion, or about \$150 per household. The government seems therefore to be meeting much of the demand from credit-worthy households, even at low interest rates. The increased share of government loans in total household borrowing between 1992-98, discussed above, supports this conclusion.

Box 1: Profile of Vietnamese Households

- 61 provinces, 527 districts, 9,801 communes and 45,000 villages
- Population: 78 million
- Total number of households: 15 million
- Rural households: 12 million (80 percent)
- Average per capita GDP was approximately 374 USD in 1999.
- Low- income households (including very poor, poor and average): 6.7 millions

But the market is segmented

Why, when the VBARD and VBP are lending so much, does the informal sector continue not merely to operate, but to do so charging high interest rates? Table 2 shows that informal sector lending was typically at interest rates double those of the formal sector, in 1997-98 and that money lenders were charging over three-times the rate of government banks.

Table 2: Average borrowing interest rates of farm household per month by sources (percent), 1997-98.

| Informal financial sector | | | Formal financial sector | | |
|---------------------------|-----------|-----------------------|-----------------------------|------------------|---------------------|
| 3.95 | | | 1.26 | | |
| Money lenders | Relatives | ROSCA and individuals | Private banks & cooperative | Government banks | Government programs |
| 4.56 | 2.63 | 3.69 | 1.59 | 1.27 | 0.87 |

Source: Vietnam Living Standard Survey, 1997-1998

There are several explanations for persistent high-interest informal sector lending:

- High risks (no collateral)
- Remoteness limiting choices
- Restrictions on formal loans limiting access
- Small loan sizes
- High transaction costs per dong lent⁶

All lending involves transaction costs and risks. Rural lending activity is arguably “more expensive” to operate as the cost of transactions is high, given the small loan sizes and the remoteness of clients. There are few economies of scale. Loan risk is also higher without collateral. Sustainable microfinance interest rates should therefore be expected to be higher than those for normal collateral-based lending.

But sometimes private lending interest rates can be very high. This could be lending to high risk clients, not merely without collateral, but also without a viable means of repayment and maybe also a record of previous defaults. It could also be because of a lack of choice for households, either because of geographical remoteness or maybe because of local market controls (some households being deliberately pushed to a few private lenders). Without choice, market failures can happen, but it is only in such rather rare cases that private lending rates can be argued to be “unfair”.

⁶ Actually, transaction costs for informal lending may be less as they may be based on little more than a handshake. There may, however, be much time spent explaining the purpose of loans, the ability to repay, and obtaining support from friends or relatives. Nevertheless, on average, the transaction cost per loan may be less than for the formal sector, although the smaller loan size in informal lending probably means a higher transaction cost per dong lent (see Tran Tho Dat, 1998).

The main reason for an ongoing strong informal sector is that the formal sector can meet demand for loans at the low interest rate only for the most credit-worthy households. In this sense rural Vietnam is indeed a “repressed financial system” where a significant proportion of households get little or nothing from the formal sector. Formal loan conditions (and maybe informal ones) act as the “rationing mechanisms” that exclude households. These policies include:

- Collateral requirements
- Use of loan conditions
- Specified loan periods and loan sizes

To secure loans, formal lenders usually require physical collateral in the form of land, a house, or durable goods. The most common type of collateral is land. Despite most rural households having land, many of them cannot use their land as collateral at financial institutions. Only about 30 percent of households have “red certificates” of land use rights. Although the Government says that farm households can undertake loans without any collateral, the VBARD still requires certificates of land use right and guarantees from local authorities as loan security. Therefore, these households without red certificates have difficulty accessing formal loans.

Government and NGO schemes often specify that loans must be used for productive purposes. The argument is that there is more chance of repayment in such cases, and as demand for cheap credit is high it should go to sustainably increasing household incomes. The problem is that this formal sector option is now closed for people wanting non-production loans. The fungibility of capital means that they can juggle savings with loans to solve many problems (see Box 2 in appendix), but for poor households this is often not possible. Poor households suffering food shortages or health problems may only be able to borrow from private money lenders in times of crisis.

The 1997-98 VLSS2 data (Table 3) shows that about 80 percent of rural sector loans are used for productive purposes (when we include buying houses)⁷. But the poorest households were more likely to take out loans for consumption purposes, and for these loans they may not have had formal sector options. By placing restrictions on the use of loan funds, NGOs and formal sector lenders are assisting the segmentation of the market and discriminating against poor households. In particular, the inability to access reasonably priced credit to buy food before harvests or in times of health crises, is probably an important contributory factor in pushing some rural households into poverty.

Finally, regulations about the length of loan periods and about minimum and maximum loan sizes also help to segment the market. Such regulations require careful justification. Setting a maximum loan size that is very small is a mechanism for “self selecting” poor households (as richer households may balk at the high transactions cost for a small loan). This seems a reasonable way of targeting the poor. In general, however, a move towards the deregulated model of the *Ho/Hui* credit groups is probably desirable.

⁷ Published tables do not report purchases of land, which may be under “working capital” or “basic investment” (GSO 2000: 330).

Table 3: Reasons for taking out loans (percentages of total loans), 1997-98

| | Rural households | Poorest households* | Richest households |
|-------------------------------|------------------|---------------------|--------------------|
| Production capital | 63.6 | 57.7 | 54.6 |
| Repay other loan | 2.7 | 2.7 | 1.9 |
| Build or buy house | 13.9 | 16.0 | 21.4 |
| Wedding, funeral, school fees | 1.7 | 3.0 | 0.8 |
| General consumption | 4.0 | 8.3 | 2.4 |
| Buy food before harvests | 0.3 | 1.0 | 0.0 |
| Other | 13.9 | 11.2 | 18.9 |
| | 100.0 | 100.0 | 100.0 |

* Note: poorest and richest households are those (rural and urban) in the first and fifth expenditure quintiles respectively.

Source: GSO (2000)

The rural credit market in Vietnam is a repressed financial sector. Demand for cheap loans outstrips supply. Rationing mechanisms to allocate the credit are biased against the poor. Poor households tend to be pushed into market segments where they have no formal sector lending options. Those with access to cheap credit may find themselves in the comfortable position of on-lending at higher interest rates to those without such access. Participants at the microfinance workshop said that such financial arbitrage activity was either “evident, but not very common” (34 persons) or “common practice” (24 persons) in Vietnam, and only five participants thought there was “very little”. A more comprehensive understanding of the credit needs and choices of poor households is required.

The negative impression concerning market structure and key policies, must be balanced against the considerable volume of state funds that have been directed into rural microfinance during the past decade. The role of the VBARD and the VBP in financing a majority of creditworthy rural households, and “crowding out” some informal moneylenders, is a major development achievement. Other notable policy and legal reforms since 1996 include:

- The trend towards positive real interest rates over the last three years.
- Greater flexibility for commercial banks in deciding on loan guarantee requirements: Government Decree 178, and Prime Minister’s Decision 67 (both in 1999).
- The switch to a base rate method of setting interest rates (SBV Decision 241 in 2000).
- The Law on Credit Institutions – introducing registration of non-credit institutions with banking activities.
- The review of the PCF’s, Politbureau Directive 57 (10th October 2000) on consolidation and improvement of the PCF system, including supervision.
- Civil Code – which clarifies rights and obligations with regard to private lending and borrowing.
- Co-operative Law – which provides a framework for the development of credit co-operatives.

The Survey Database

Overview

The DFID-SBV microfinance survey managed to collect information about 84 schemes in operation throughout Vietnam. The quality and comprehensiveness of responses was adequate (given the time constraint), although detailed financial data was often difficult for scheme operators to provide. The survey encompassed 4546,608 savings groups with a total of 1.7 million persons (but with only 65,384 savings accounts). The average interest rate on lending was 1.17 percent per month, and 0.76 percent for savings. The total value of outstanding loans made by the 84 schemes came to \$377 million on 30 June 2000, of which \$249 million were in eight large VBARD/VBP schemes. Thus the remaining 76 schemes, which were mostly foreign NGO schemes, came to \$131 million, which is 35 percent of the database. The NGO schemes, however, are equivalent to only 7.6 percent of formal government schemes (\$1.9 billion), and therefore about 4 percent of total rural microfinance lending when we include the informal sector as well.

The small total volume of NGO schemes means that their significance comes from, firstly, their targeting of households excluded by the formal sector, and secondly, by testing new ways of doing microfinance in Vietnam. We might also add that the NGO community could play another important role by spreading ideas and information about schemes, and by lobbying the government for policy changes.

Determining a typology of schemes is difficult. Table 4 shows a breakdown by size of credit groups. The large VBARD/VBP schemes involved lending directly to households, which therefore accounted for 83 percent of loan funds. Most other funds were lent through groups of 10 to 14 persons.

Table 4: Typology of schemes by credit group sizes

| Average size of recipient group* | Number of schemes | Balance of loans outstanding 2000 (billions of dong) | Percentage of all loans | Dollars (14,800 dong to \$) (millions of \$) |
|----------------------------------|-------------------|--|-------------------------|--|
| 1 | 13 | 4,619 | 82.8 | 312 |
| 5 to 9 | 32 | 95 | 1.7 | 6 |
| 10 to 14 | 17 | 610 | 10.9 | 41 |
| 15 to 20 | 11 | 154 | 2.8 | 10 |
| 21 to 40 | 8 | 17 | 0.3 | 1 |
| 60 to 70 | 3 | 83 | 1.5 | 6 |
| Total | 84 | 5,578 | 100.0 | 377 |

* "1" refers to one person or household, while numbers >1 are in persons.

Source: DFID/SBV microfinance database.

Another breakdown is to consider those schemes that are exclusively microfinance and those that are integrated with other activities. Some 47 schemes reported being integrated, while the VBARD/VBP schemes and about 20 other NGO schemes were exclusively microfinance. Many NGOs therefore view microfinance as a means to an end rather than an end in itself.

Some use microfinance to “open the door” to enable health and family planning education. This can be very effective. Microfinance schemes integrated with other activities can exploit economies of scope which can piggy-back microfinance on top of other organisational frames (e.g. collectives that emerge around irrigation services), or exploit complements in household production and welfare improvement (e.g. training in special cultivation, special livestock care, birth control, and infant care can be linked to funding for these activities).

Others feel that finance alone is not enough and that training for normal productive activities is also required (e.g. pig breeding). Maybe such production training is needed if the target is “the poorest of the poor”, but obviously many schemes do well without such training. There are no clear answers, and solutions can vary between regions anyway. What is needed are well designed experiments that contribute to a general understanding about “what works where”. At present there is some experimentation, but not a great deal, and evaluations and dissemination of “lessons learned” is weak.

A further breakdown is afforded by looking at the big schemes separately, as they skew the whole database. Table 5 shows details of the “big ten” schemes on the database. The largest is a World Bank credit to the VBARD, which is lent out at normal VBARD rates. The others are all government schemes (except the Central Credit Fund), involving highly subsidised lending⁸. These ten schemes total 91 percent of funds on the database. They, like many other schemes required that loans be used for productive purposes, the most common of which was to raise livestock. Of the 45 schemes reporting “purpose of loans”, 54 percent of funds went to livestock, 37 percent to “cultivation and processing”, and 15 percent to “other”. Given the fungibility of capital, however, it is hard to say what was the real impact of these loans.

Table 5: The “big ten” schemes on the database

| Name of credit scheme | Average group size (persons) 2000 | Balance of loans outstanding 2000 (billions of dong) | Monthly lending interest rate (%) | Share of lending going to livestock | Number of provinces in which project is active |
|-------------------------------|-----------------------------------|--|-----------------------------------|-------------------------------------|--|
| Rural Finance 2855 – WB | 1 | 1,014 | <i>1 to 1.05</i> | <i>37.0</i> | 44 |
| VBARD | 1 | 983 | <i>0.7</i> | | 10 |
| VBARD, storms 1997 | 1 | 961 | <i>0.5</i> | | 13 |
| Agricultural Recovery Project | 1 | 530 | <i>“market”</i> | <i>52.0</i> | 13 |
| VBARD Rural Credit, ADB | 1 | 394 | <i>“market”</i> | <i>51.5</i> | 38 |
| 1999 Flood Recovery | 1 | 347 | <i>0.3 to 0.4</i> | | 9 |
| Central Credit Fund | 10 | 313 | | | |
| Bank for the Poor | 14 | 221 | <i>0.7</i> | <i>21.1</i> | |
| Employment Promotion Fund | 1 | 168 | <i>0.5</i> | <i>30.0</i> | 61 |
| Agricultural Credit CFD | 1 | 137 | <i>“market”</i> | <i>11.0</i> | 8 |
| TOTAL | | 5,068 | | | |

Source: DFID/SBV microfinance database.

⁸ As mentioned previously, normal VBARD/VBP lending was not included on the database due to some confusion about definitions. It could be included, along with other small schemes that escaped the survey net, but the need to build and maintain a comprehensive database needs to be justified. It could be useful as part of a Microfinance Forum, discussed below, but the data reporting requirements should be kept to a minimum.

Table 6 shows data about the larger international NGO schemes from the database (there were only two small Vietnamese NGO schemes covered). The total value of loans outstanding from these nine schemes was 255 billion dong in 2000 (less than US\$18 million) - about the equivalent of a small scheme in Table 5. The loan interest rates charged by these schemes were generally in line with VBARD, and savings mobilisation was either zero or modest. All the schemes integrated microfinance with other activities and objectives that, as discussed above, offers particular advantages. The challenge, however, is to integrate with other activities (e.g. family planning education) while maintaining the microfinance element as a self-sustaining and accurately costed component.

Table 6: The larger International NGO schemes

| Name of donor organisation | Average size of credit groups (persons) 2000 | Balance of loans outstanding 2000 (millions of dong) | What is the lending monthly interest rate? 2000 | Balance of savings accounts 2000 (millions of dong) | Monthly interest rate on savings deposits 2000 | Number of provinces covered | Is the scheme integrated? |
|----------------------------------|--|--|---|---|--|-----------------------------|---------------------------|
| Rabo Bank | 60 | 82,291 | 0.7 | 11,930 | | 8 | Yes |
| German Restructuring Bank (KFW2) | 18 | 51,538 | Market rate | | | 3 | Yes |
| IFAD | 12 | 41,193 | 1.0 | 32 | | 1 | Yes |
| UNFPA | 17 | 25,808 | | 745 | | 8 | Yes |
| UNICEF | 13 | 14,565 | 1.0 | 6,402 | 0.15 - 1.0 | 22 | Yes |
| Save The Children UK (DFID) | 5 | 11,435 | 2.0 | 2,799 | 1.4 | 1 | Yes |
| American Oxfam | 5 | 10,005 | 1.0 | 3,643 | 0.5 | 5 | |
| Vietnam-Sweden MRDP | 40 | 10,000 | 1.0 | | 0.2 - 0.6 | 5 | Yes |
| German Restructuring Bank (KFW1) | 15 | 7,988 | 1.2 | | | 1 | Yes |

Source: DFID/SBV microfinance database.

Where are those 1996 NGO schemes?

The 1996 microfinance report studied ten schemes in detail. We tried to find these same schemes in 2001, but with limited success. Table 7 shows nine ongoing schemes that closely resemble the original ten. All of the five schemes that reported 1996 and 2000 “persons covered” data had increased their coverage by 2000. The coverage by these five schemes had increased from 47,218 persons in 1996, to 86,112 in 2000. However, these are well established and experienced schemes, with sustainable design and in a conducive environment, we might have expected one or more of such schemes to expand exponentially. Is something holding back the rapid expansion of these schemes, or are they holding themselves back?

Table 7: Comparison of same or similar schemes, 1996-2000

| Donor | Scheme started | Average group size (persons) | loans outstanding, 2000 (thous. dong) | Total number of S&C groups | Persons covered 1996 | Persons covered 2000 | Average % of women groups (1996) 2000 | Monthly lending interest rate (1996) | Monthly lending interest rate (2000) |
|-------------------------|----------------|------------------------------|---------------------------------------|----------------------------|----------------------|----------------------|---------------------------------------|--------------------------------------|--------------------------------------|
| AVV2 | Aug-93 | 18 | 1,340,326 | 247 | 1,793 | 4,446 | 100 | 2.5 | 1.5 |
| MRDP1 | Dec-91 | 40 | 10,000,000 | 300 | 6,160 | 12,000 | (40) 25 | 1 to 1.5 | 1.0 |
| OXFAM UK | Aug-95 | 10 | 1,119,343 | | | | | 1.5 | |
| PCF(center) | | 10 | 312,796,969 | | | | | | |
| Care VN | | 5 | 740,206 | 364 | | 1,895 | 100 | 1.0 | 1 |
| Gret (10 fund programs) | Oct-95 | 70 | 251,300 | 9 | | 490 | 100 | 0.6 | 0.6 |
| UNICEF2 | May-93 | 13 | 14,565,000 | 3,220 | 33,584 | 41,860 | 100 | 2 to 3.5 | 1.0 |
| UNFPA | | 17 | 25,808,000 | 913 | 991 | 15,521 | | 2.5 | |
| SC/UK1 | Mar-93 | 5 | 11,435,016 | 2,457 | 4,690 | 12,285 | 100 | 2.0 | 2.0 |

Source: DFID/SBV microfinance database.

The “crowding out” of NGO schemes by the VBARD and VBP was mentioned several times to the survey team. Certainly the rapid expansion of formal sector finance has narrowed the market for NGOs, but that “market segment” remains large and includes many poor households. There is plenty of room for growth. Another more important external constraint on NGO scheme growth is the slow development of an appropriate regulatory framework and legal status for such schemes.

The main cause of modest expansion is, however, the internal policies that inhibit development of truly sustainable schemes. The nine schemes, with the exception of Save the Children UK, have generally followed the VBARD in setting their lending interest rates. The low lending rate means that savings rates must also be low, leaving an interest rate spread of between 1 to 0.4 percent. At low rates, saving becomes less attractive. Also, schemes that make savings a compulsory form of deposit insurance foster a “minimum balance only” mentality. With low returns and restrictions on access to savings it is hardly a surprise that households appear “reluctant” to save.

Table 8: Savings data of similar schemes, 1995-2000

| Donor | Number of savings accounts 99 | Savings 1999 | Savings 2000 | Monthly interest rate on savings deposits 1995? | Monthly interest rate on savings deposits 2000? | Provinces covered 1995 | Provinces covered 2000 |
|----------|-------------------------------|---------------|---------------|---|---|------------------------|------------------------|
| AVV2 | | 844,373,460 | 808,886,910 | 2.0 | 1 | 1 | 1 |
| MRDP1 | 12,000 | | | | 0.2 - 0.6 | 2 | 5 |
| OXFAM UK | | 259,306,100 | 280,242,700 | 1.5 | | 1 | 1 |
| UNICEF2 | 32,439 | 7,775,892,000 | 6,402,483,000 | 1.5 to 2 | 0.5 -1.0 | 16 | 22 |
| UNFPA | | 689,271,000 | 744,530,000 | as VBARD | | 2 | 8 |
| SC/UK1 | 11,583 | 2,213,322,000 | 2,799,261,000 | 1.5 | 1 | 3 | 1 |

Source: DFID/SBV microfinance database.

Unable to mobilise savings, the expansion of NGO schemes becomes dependent upon grants to build up the capital base, and on ongoing subsidies to maintain that capital base. The “binding constraint” on expansion is therefore the availability of donor funding.

Interest rates

Determinants of lending interest rates

The survey asked scheme managers to explain how they determined their lending and savings interest rates. Of the 78 answers, ten replied that it was a government decision as they were government schemes, and 29 said that they set rates with reference to the government scheme rates. That left only 30 schemes that specified other reasons, of which 18 made mention to costs and financial sustainability. The nine talking about “market interest rate” invariably meant the VBARD rate.

Not one scheme mentioned the rates of private money lenders. This is remarkable because the private lenders with their high lending rates are surely the market operators that NGO schemes would like to “crowd out”. If NGO schemes can offer many loans at rates lower than private lenders then they do a great service. Instead, however, NGO schemes seem to view the VBARD as their competitor, and feel that rates above the VBARD rate are either somehow “unfair” or uncompetitive. If it is uncompetitive, then the NGO scheme is obviously not servicing the market segment that private lenders are servicing (maybe because of use of loan conditions), which is a pity because that segment, as discussed above, includes a high proportion of poor households.

Table 9: Determinants of lending interest rates

| Lending interest rate decided by: | Numbers of schemes |
|---|--------------------|
| 1. Reference to VBARD/VBP/SBV rates | 29 |
| 2. Government decision (e.g. VBARD schemes) | 10 |
| 3. Local authorities and scheme management | 3 |
| 4. Desire to cover operating costs | 8 |
| 5. Mention of "market interest rate" | 9 |
| 6. Financial sustainability analysis | 10 |
| 7. Criteria not specified | 9 |
| TOTAL | 78 |

Source: DFID/SBV microfinance database.

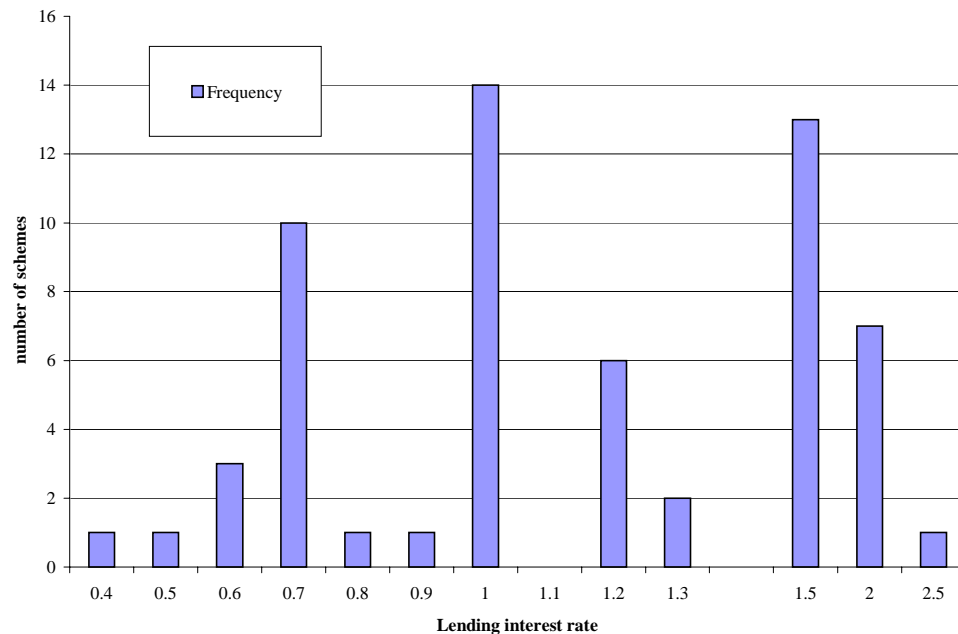
Actually a minority of schemes in the survey reported charging lending rates of 1.5 percent per month or greater (Figure 3). Of 60 reported lending interest rates, 15 schemes were charging 1.5 percent per month, and another 8 schemes were charging 2 to 2.5 percent (31 schemes were charging 1 percent or less). Given current deflation, rates of about 2 percent may be financially sustainable and have the scope for savings mobilisation. Costs, however, differed greatly between schemes and depended on repayment performance, operational costs, and the cost of funds. Accurate data on costs was reported by few schemes, mostly because they did not have such data. This in itself is revealing about the lack of attention to financial sustainability, which would require of any scheme:

- A uniform, simple accounting system that accords with general accounting practice and from which an accurate balance sheet and income and expenditure account can be extracted.
- Accurate loan repayment tracking mechanisms
- Skills to interpret financial information and plan for sustainability on the basis of this information
- Policies to set interest rates which will cover appropriate costs

Two of these eight “high interest” schemes had managed to mobilise savings equal to one-quarter of lending, but this due to high savings interest rates that cut the spread down to 0.4-0.5 percent⁹. Also, however, savings in these two schemes were compulsory conditions for access to loans. It remains to be seen how such schemes will develop.

⁹ These are two Save The Children (UK) schemes.

Figure 3: Frequency distribution of scheme lending interest rates



Determinants of savings interest rates

The poor value security above all else. Access to credit at times of great need increases security, and so does providing very safe and instantly accessible savings facilities. Even households that suffer periodic food insecurity also have times of relative food surpluses. If they can save small amounts during surplus periods, they can draw upon those savings in deficit periods instead of having to borrow funds.

Nevertheless, less than half (39/84) of all schemes on the survey database reported collecting savings from households. That makes the schemes listed in Table 8 above rather exceptional, as five of these six “veteran” schemes were trying to mobilise savings. Of the 39 schemes reporting savings, only two reported savings being over 50 percent of loans in 2000, five schemes had savings between 30-50 percent of loans, and eight had savings between 20-29 percent. The other 24 schemes had savings equivalent to less than 20 percent of loans.

Table 10: Determinants of savings interest rates

| Savings interest rate decided by: | Number of schemes |
|---|-------------------|
| 1. Reference to VBARD/VBP/SBV rates | 14 |
| 2. Government decision (e.g. VBARD schemes) | 10 |
| 3. Local groups and scheme management | 8 |
| 4. Considering costs and inflation | 3 |
| 5. "Common market rate" | 6 |
| 6. Percentage of lending rate | 1 |
| 7. Criteria not specified (or no savings) | 36 |
| TOTAL | 78 |

Source: DFID/SBV microfinance database.

The ability to mobilise savings is constrained, first and foremost, by the policy of setting low lending interest rates. To this, however, we might add a general disinterest by many NGOs to provide savings services to the poor. The poor, according to some scheme designs and workshop participants, need to be “taught how to save”. This is probably a misunderstanding relating to relative perceptions of risk and uncertainty, based on different historical experiences and information sets. Building confidence in savings institutions may also require marketing and related efforts¹⁰. Offering safe and accessible savings options may therefore only be a first step.

The formal neglect of savings

NGOs have probably followed government policies and attitudes concerning savings to some extent. The government, and hence the NGO interest rate structure is a major constraint on expanding the outreach of microfinance services to the poor. Further, the minimum deposit accepted by VBARD branches is 50,000VND, and by other commercial banks 100,000VND. VBARD deposits are overwhelmingly urban with only a small proportion coming from rural households. Therefore, so long as other institutions follow the VBARD, there remains a dire shortage of well-designed instruments for mobilizing public savings. It would be interesting to see some NGO schemes focused primarily on mobilising savings, with lending considered a secondary function.

The VBARD savings performance is, however, very erratic. Table 11 shows that savings as a percentage of loans varies from 92 percent to 2 percent across nine provincial branches. The poorest province have the lowest savings ratios, but the huge variation is something of a mystery. The role of the VBARD as a lending and savings institution warrants a very detailed economic study.

¹⁰ One scheme in Indonesia runs a monthly lottery for a motorbike in which all those with a specified minimum savings account balance are automatically entered “for free”.

Table 11: Saving mobilization versus outstanding loans ('000 dong)

| Provinces | Savings mobilizations | Outstanding loans | Deficit ('000 dong and savings as % of loans) | |
|-----------|-----------------------|-------------------|---|----|
| Ha Tay | 57,290 | 674,551 | -617,261 | 8 |
| Phu Tho | 312,101 | 389,292 | -77,191 | 80 |
| Yen Bai | 164,369 | 219,010 | -54,641 | 75 |
| Hue | 104,556 | 265,029 | -160,473 | 39 |
| Binh Dinh | 210,331 | 229,942 | -19,611 | 91 |
| Kom Tum | 16,842 | 172,892 | -156,410 | 10 |
| An Giang | 19,913 | 959,908 | -939,995 | 2 |
| Soc Trang | 84,275 | 334,946 | -250,671 | 25 |
| Ben Tre | 192,498 | 369,883 | -177,385 | 52 |

Sources: report of 9 VBARD provincial branches

Regional variation

Regional differences, as suggested by Table 11 above, can be very important in any country. In Vietnam, despite general ethnic homogeneity, regional differences seem important. The survey asked if and why regional differences in the success of schemes was important. Of 51 answers, differences in general economic and educational characteristics were noted by 20 scheme managers, while the particular role of local partners and authorities was cited by 36 scheme managers (Table 14).

Table 12: Reasons for geographic variance in scheme achievements

| Reasons for geographic variance: | Surveyed schemes mentioning this |
|---|----------------------------------|
| Economic and business conditions of the area | 6 |
| Higher relative education levels in general | 14 |
| Good management and local authorities | 16 |
| Enthusiastic, experienced and/or trained local partners | 10 |
| Good cooperation & coordination with local authorities | 4 |
| Continuity of credit officials | 1 |

Source: DFID/SBV microfinance database.

VLSS2 data shows significant variation in the sources and uses of microfinance in Vietnam (Table 13). In some regions, particularly in the South Central Coast, the government banks are relatively unimportant. Government bank loans are most common in the Mekong River Delta and in the Central Highlands. The reasons for taking out loans also vary greatly. Most notably, however, the average loan interest rate varies from 1.7 to 3.6 percent across the seven regions of Vietnam. The average interest rate is lowest in North Vietnam, ranging from 1.74 to 1.83 percent across the three northern regions, and is highest in South Vietnam, peaking at 3.63 percent in the Southeast region (Ho Chi Minh City). This basic finding suggests that Vietnamese internal financial markets remain highly distorted and segmented.

Table 13: Differences in sources and uses of loans across Vietnam, 1997-98.

| Share of households with loans outstanding: | <u>Regional variation:</u> | | |
|---|----------------------------|----------------------------------|----------------------------------|
| | Of all households | Lowest percentage of households* | Highest percentage of households |
| Total | 50.2 | 39.4 | 56.8 |
| <u>To:</u> | | | |
| Private money lenders | 6.4 | 3.2 | 11.9 |
| Relatives | 14.0 | 7.8 | 22.7 |
| Other individuals | 11.1 | 8.5 | 13.4 |
| BPV | 6.1 | 3.2 | 9.2 |
| Other government banks | 22.5 | 11.0 | 36.7 |
| Socio-economic dev. Programs | 4.9 | 3.0 | 12.1 |
| ROSCAs, private banks, others | 3.6 | 1.6 | 5.2 |
| <u>Reasons for taking out loans:</u> | | | |
| Production or basic construction | 66.3 | 51.2 | 90.4 |
| Buy or build a house | 10.3 | 4.0 | 13.2 |
| Buy consumer durables | 2.9 | 0.2 | 4.7 |
| General consumption and food before harvest | 3.3 | 0.5 | 8.4 |
| Others | 17.2 | 5.0 | 42.3 |
| <u>Average loan interest rate</u> | 2.3 | 1.7 | 3.6 |

* Note: These are the lowest and highest percentages out of the seven regions of Vietnam: North Mountain and Midland; Red River Delta; North Central Coast; South Central Coast; Central Highlands; Southeast; Mekong River Delta.

Source: GSO (2000)

An understanding of regional differences must guide the design and implementation of any microfinance scheme. They are particularly important, however, when considering the expansion of one model of “doing microfinance” into another region or maybe across all of Vietnam. Such “scaling up” of a successful model may encounter such problems unless regional flexibility is incorporated from the outset.

Gender and microfinance

That much rural microfinance in Vietnam is channeled through women, and in particular the Women’s Union, is something of a myth. This is only the case for many of the small NGO schemes, an uncertain percentage of informal lending, and for some VBARD lending. The vast majority of rural loans are, however, made to men.

The workshop participants were strong in their support for women-only groups, which 29 thought were “a bit better” than other forms, and 34 considered “much better” (only 3 thought they were much the same). But of course these were mainly representatives from the many small foreign NGO schemes that work through the Women’s Union. Their success is notable, although it is also reported that repayment rates are still very high with lending to men. There has been no detailed study on this matter, and in particular of the detailed story behind VBARD and VBP lending, but the general impression is that “microfinance works” in Vietnam (and it probably works better when dealing directly with women). The existing

“social capital” networks in Vietnam hold great promise for the development of strong and substantial NGO microfinance schemes, yet the largely unexploited nature of this potential is a source of frustration. Vietnamese and foreign NGOs need a solid legal and institutional base upon which to expand.

Desired legal and institutional reforms

The DFID-SBV survey sought the opinions of scheme managers about what they wanted to see changed. For most this meant changes to the external environment in which their modest schemes operated, although for some, such as VBARD and VBP officials, concerns for internal policy and administration changes were expressed.

Internal policy concerns included changing interest rates and allowing more decision-making autonomy in some areas. Some of these proposed changes related directly to the VBARD. Quite a few scheme managers complained that the supervision of “guiding organisations” was too detailed, including three specific mentions of the Women’s Union in this regard. The degree of decentralisation of activities is always a controversial matter, but it is probable that supervision is often excessive.

The strongest and most common views, however, were for changes to the external legal environment facing NGOs. Some 24 schemes made specific mention of the need to clarify the legal status of schemes, and to promulgate a detailed legal framework for their operation. There were strong views expressed concerning this matter during interviews, and many NGOs felt that their development was being rather neglected by the government.

Table 14: Legal and institutional changes identified by microfinance organisations

| Desirable legal and institutional changes identified: | Surveyed schemes mentioning this |
|---|----------------------------------|
| <i><u>LOANS: TO WHO, FOR WHAT, AND HOW MUCH</u></i> | |
| Make interest rate more flexible | 4 |
| Higher interest rate | 3 |
| Allow more flexible use of loans | 1 |
| More autonomy to select target borrowers | 1 |
| Higher loan ceiling | 1 |
| <i><u>LEGAL STATUS</u></i> | |
| "improving legal framework" | 6 |
| Specifying legal framework for S&C groups | 6 |
| Provide legal status for NGO schemes | 4 |
| Legal framework: create law on credit activities of non-credit institutions | 3 |
| Prudential regulation for organisations collecting savings | 2 |
| Land mortgage register system | 1 |
| Allow/legalise private microfinance institutions | 1 |
| Remove the requirement of owning resident certificate | 1 |
| <i><u>VBARD: REACH AND FLEXIBILITY</u></i> | |
| Promote VBARD's active right to transfer capital between districts | 2 |
| Establish VBARD branches in remote areas | 1 |
| Higher commission for organizations providing VBARD services | 1 |
| <i><u>MONITORING AND REPORTING</u></i> | |
| Simplify supervision by "guiding" Vietnamese organisations | 5 |
| Simplify procedures and bureaucracy of Women's Union | 3 |
| Better information (transparency) | 3 |
| Improve auditing capacity | 2 |
| Strengthen reporting requirements | 1 |

Source: DFID/SBV microfinance database.

Where are NGOs going?

The survey asked about the future plans for each scheme¹¹. As Table 15 shows, many schemes expressed an intention to expand their operations, but others were content to just maintain the present scheme. Only two schemes mentioned goals of linking to the formal financial institutions, and two more mentioned financial sustainability. A single scheme mentioned that they have some sort of plan to “push for legal reforms”. The overall picture, however, is one of “business as usual”. The lack of strategic focus for the whole sector is reflected in the modest ambitions of the individual schemes. Those ambitions, it might be added, are matched by uninspiring project evaluation reports (with some notable exceptions). Impact studies generally lack control groups and the use of a methodology to isolate the

¹¹ It should be noted, however, that little time was available for discussion with NGOs on their plans and visions for the future.

impact of the schemes. “Success” is often based upon nothing more than the observation that households were now better off, or that the scheme is functioning in delivering cheap credit. Sustainability discussions rarely address financial sustainability comprehensively. A research agenda, possibly pursued under a Microfinance Forum, would focus attention of evaluation and other issues.

Table 15: Future plans of surveyed microfinance schemes

| Plans for action in the future: | Surveyed schemes mentioning this |
|--|----------------------------------|
| Expanding to other locations | 25 |
| Sustaining/continuing present scheme | 16 |
| Hand-over to local partners | 11 |
| Training | 8 |
| Upgrade rural infrastructure | 6 |
| Strengthen links to formal sector finance institutions | 2 |
| Achieve financial sustainability | 2 |
| Better targeting of poorest households | 1 |
| Push for legal reforms | 1 |

Source: DFID/SBV microfinance database.

The brightest prospects concern the eight schemes charging two percent or more for loans, and maybe some other schemes which are profitable at lower interest rates. These have potential for self-generated growth. These schemes should link their *savings* interest rate to some index of inflation, possibly the national Retail Price Index¹².

Operating costs would then be calculated to determine the minimum interest rate spread, and thus reveal the minimum lending interest rate. Of course all costs need to be accounted for, including training, monitoring and auditing. Five of these eight schemes reported having mobilised savings, although at most these were only 25 percent of lending volume. More attention is needed to study savings in Vietnam. How to determine an interest rate that is competitive with other options households may have? How to design and “sell” a savings service that is safe and accessible? The total value of lending through these eight schemes came to only US\$2 million, but hopefully they will grow rapidly over the next five years.

¹² Some index of the cost of living for poor rural households would be better. Such a “price index for the poor” is yet to be developed. Adjustments of nominal interest rates could then occur on a regular basis, say every three months.

Next step: a Microfinance Forum?

Towards the end of the DFID-SBV workshop, participants answered a questionnaire regarding possible next steps for collaboration. Nearly all felt that some regular forum for discussing microfinance in Vietnam was required, and 17 participants felt that their organisation would even provide modest funds towards such a forum.

The questionnaire then sought opinions concerning the relative importance of issues that might be addressed by such a forum (Table 16). The strongest positive support was for a forum that would develop understandings about “best practice” in Vietnam, while also have an advocacy role to push for specific policy reforms. The participants did not feel that maintaining a detailed database of schemes was particularly needed, but that a database of “basic information” (who is doing what and where) would be useful.

Table 16: How useful is it for the foreign and Vietnamese NGOs to...

| | Not useful | Just useful | Useful | Very necessary |
|---|------------|-------------|--------|----------------|
| Share basic information about microfinance schemes? | 0 | 13 | 19 | 16 |
| Share detailed information about microfinance schemes? | 5 | 24 | 11 | 7 |
| Meet at least twice per year to discuss microfinance issues? | 0 | 9 | 22 | 17 |
| Formulate joint understandings about “best practices” in Vietnam? | 1 | 6 | 21 | 18 |
| Formulate joint statements about policy matters (e.g. legal status)? | 3 | 7 | 16 | 18 |
| Develop a standard system of bookkeeping and reporting for schemes? | 5 | 10 | 18 | 15 |
| Investigate economies of scale possibilities for training and auditing? | 0 | 16 | 17 | 13 |

Source: DFID-SBV microfinance workshop.

The forum would be most effective if policy makers from the Vietnamese banking sector, major donors to Vietnam, NGOs and mass organizations would all participate. Workshop participants felt that the Forum should meet quarterly, and invite a guest-speaker to deliver a keynote address and lead discussion on one selected topic.

A Forum could also sponsor a research agenda that could follow on from this report and prior studies, including:

- An evaluation of microfinance management capacities and training needs.
- A review of bookkeeping and auditing systems with a view towards harmonisation across schemes.

- An evaluation of impact assessment and sustainability methodologies.
- A study of savings schemes, including deposit protection and mobilisation arrangements.
- A study of informal sector microfinance activity to see what may be applicable to formal schemes.
- The review and drafting of proposed legal documents.
- A study of urban microfinance schemes.
- Detailed economic evaluations of VBARD and the VBP.
- A study of the institutional capacity and needs of the Vietnam Women's Union.

Concerns mentioned by participants and organizers of the DFID-SBV meeting include:

- Costs involved in terms of staff time, preparing for meetings, etc. Could costs be shared among participants? How to pay for the visits by experts to Vietnam?
- How to include Vietnamese policy makers and partners such as the Women's Union and the Farmer's Union?
- How to make it relevant at the national, provincial and local levels, and how to enlist the participation of groups in the center and south who would like to participate?

Participants suggested that the new Forum must have a clear structure, objectives, and be tightly organized. It should work as a group to achieve things: vote on key issues, achieve consensus specific actions and recommendations regarding policies and laws governing microfinance in Vietnam. It should also be clarified whether this would indeed be a Forum or an Association.

Actually, a *Savings and Credit Forum* operated in Vietnam several years ago and provided useful services to participants, though it went into decline when some of its organizers left the country. Thus, the first concern is who would sustain this forum – providing leadership, direction and energy and ensuring that it is sustained? It would be best if one donor - NGO, bilateral or multi-lateral - were to put up their hand. A lump-sum contract to establish and manage the forum over some years could be part of a technical assistance package linked to rural lending activity. NGOs would then be invited to bid to manage this sub-project. Alternatively, one NGO could take up the responsibility using their funds. Whatever the source of funds, there is a strong demand for an active forum, and there is a need for a more proactive approach to policy reform. Funding for a well-organised and focused forum can be strongly justified as an investment in “good governance” for microfinance in Vietnam.

Conclusion

This report has highlighted a number of problems concerning microfinance in Vietnam. These concerns, however, should not cloud the general picture of substantial progress during the past decade. The move by the government to allocate significant funds for the rural banking system is the most notable achievement. The government has also been active in developing experiments with new forms of credit cooperatives, and it is now seeking to mobilise savings through post offices. The missing element is the lack of a clear legal status and a prudential regulatory framework to encourage development of the non-state sector to provide microfinance services.

The lack of institutional support has frustrated the NGO community. The conditions of “social capital” in Vietnam are ripe for the rapid expansion of microfinance schemes along the lines of those in Indonesia and Bangladesh¹³. But the NGO schemes have also constrained themselves. NGO activity in microfinance may be characterised as “variations around a theme”, that theme being an acquiescence to government interest rate policies and a subsequent neglect of savings mobilisation. There are exceptions, but they are few, and there are many more schemes that are just “door opening” subsidies for other project objectives. There is a need for some schemes to aggressively strive for financial sustainability based upon mobilising savings.

The donor community in general has relatively neglected Microfinance. The multi-lateral and some bilateral donors are showing renewed interest, but only in recent years. There is great scope for expansion into Vietnam’s segmented and inefficient rural financial markets. A detailed understanding of these markets, and in particular the role of the government banks, is needed to guide scheme designs and to enable targeting of the poor. A pro-active Microfinance Forum could play a central role in the whole process, both as a source of information and research, and as a focal point for policy advocacy.

¹³ Social capital refers to the existing networks of cooperation and management, such as village-based groups and mass organisation structures. They mean that microfinance schemes can build upon existing group structures instead of having to develop new ones.

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Appendix: Organisations and market structure

The role of the State

In 1999, as much as 5.9 million households have access to formal financial institutions, of which 2.7 million households are the poor and low-income households (Dao V.H: 1999). The VBARD dominates formal sector lending in rural Vietnam. It reportedly lent to 33 percent of rural households in 1998 (Table 17). The VBARD's loan portfolios have expanded rapidly since 1992 and the supply of funds to credit-worthy households is substantial. Table 2 also shows that VBARD lending also reaches rural low-income houses to a significant extent, even if not maybe to "the poorest of the poor".

Table 17: Formal financial sector outreach, 1998

| | <i>Rural households</i> | | <i>Rural low-income households</i> | |
|---------------------------------|-------------------------|----------------|------------------------------------|----------------|
| | <i>Thousand</i> | <i>Percent</i> | <i>Thousand</i> | <i>Percent</i> |
| VBARD | 4,000 | 33 | 1,800 | 27 |
| VBP | 1,300 | 11 | 600 | 9 |
| People's Credit Funds (PCFs) | 600 | 0.5 | 300 | 4 |
| Total | 5,900 | 45 | 2,700 | 40 |

Source: Dao Van Hung, 1999

Before the Vietnam Bank for the Poor (VBP) was established in 1996, the VBARD had established and managed *the credit program for the poor* that concentrated on provision of cheap credit to the poor. After 1996, the Bank ceased providing cheap credit to the poor, although large numbers of low-income households remain customers.

With its nationwide network from the province to commune level, the VBARD is the biggest formal financial institution. After six years, the VBARD has expanded rapidly to 1,271 branches in 1998. The bank now has four types of branches: central, province, district and commune, including the operation center in Hanoi (head office), two regional branches, 61 province branches, 527 district branches, 604 inter-commune banks, 75 mobile banks.

Funds from savings mobilization have been major sources, reportedly making up about 80 percent of total funds in 1998. Public savings are mobilized mainly through provincial branches in cities or central towns. District and inter-commune branches are encouraged to mobilize savings at the local areas. However, branches and units of the VBARD at the grassroots level have paid little attention to mobilizing small public savings from the poor and low-income households. Deposits under 100,000 VND are rare and deposits from 100,000 to 500,000 accounted for only 1 percent of total mobilized funds in 1998.

The VBARD has switched from corporate sector lending to lending mainly to the household sector. In 1998, as much as 63 percent of outstanding loan funds were to households. Loan approval is based upon estimating capacity to payback loans. Usually, the VBARD provides

a loan less than 70 percent of assessed value of household assets, which serve as collateral. The bank usually makes short loans, and about 75 percent of all loans are under 12 months.

According to the Bank's definition, a small loan is less than 5 million VND. A report about nine provincial branches showed that almost half of bank loan funds went to loans of over 5 million dong, although 16 percent of its customers were getting loans of only up to one million dong. The VBARD does not seem to be excluding credit-worthy poor households (i.e. with asset collateral). The lending interest rate for VBARD is normally 1.0 percent/month (1.05 percent/month on long term loans).

Table 18: VBARD customer structures by loan size, 1998

| | Loan size (million) | | | | | Total |
|---------------------------------|---------------------|--------|---------|---------|---------|---------|
| | <0.5 | 0.5-1 | 1-3 | 3-5 | >5 | |
| Number of loans | 32,476 | 74,263 | 188,571 | 220,431 | 145,805 | 661,546 |
| Share of customers (%) | 5 | 11 | 29 | 33 | 22 | 100 |
| Share of total loans (%) | 0.6 | 2.3 | 15.6 | 34 | 47.5 | 100 |

Sources: Report of 9 selected provincial branches

The total assets of the Vietnam Bank for the Poor (VBP) have been expanding rapidly since 1996 from 1,962 to 4,126 billion VND in 1999. At the end of 1999, total loanable funds increased to 4,086 billion VND. Borrowed funds are the major sources of fund of the VBP, making up 72 percent of total funds in 1999. Saving mobilization through deposits is trivial.

The VBP lends directly to the poor based on a "loan application list" provided by its credit and saving groups or by local authorities. Up to the end of 1999, over 2.3 million poor households obtained loans from the VBP with total loan amount of 3,879 billion VND (276 million US dollar)¹⁴. The maximum loan term is 36 months, and the maximum loan limit is 2.5 million VND (170 USD). The interest rate of loans has been held at 0.7 percent per month, of which local social organizations keep 0.1 percent towards monitoring costs, the VBARD keeps 0.25 percent for administration costs, and the VBP keeps the remaining 0.35 percent to cover the cost of capital charged by the head office.

The non-VBARD/VBP sector

Informal sector lending, as Table 1 showed, remains of great importance in rural Vietnam. Informal lending includes group lending, and a more structured form of this has emerged as People's Credit Funds (PCFs) in recent years. There are also experiments with joint-stock banks and foreign NGO schemes, but the scale of these remains small. Finally, there are various government subsidised lending schemes targeted for specific purposes (e.g. reforestation, or "creating employment").

The informal financial network providing credit to households includes:

¹⁴ Exchange rate is 14 500 VND/1 USD

- Private moneylenders
- Relatives, friends and neighbors (often without interest)
- *Ho/Hui*, which are local rotating savings and credit associations (ROSCA)

There are three types of private moneylenders in Vietnam. Firstly, the "*traditional*" type of money lending involves lending based on mutual confidence, using simple procedures, without any written loan contracts. Such traditional loans are typically short-term lending in cash, sometimes just for a few days. Secondly, there is the "*mortgage and pawn-broking*" type of lending. Generally, it is similar to the first type, but the lenders require borrowers to have assets or land as collateral. The third type of private money lending is through small traders, input suppliers and marketing agencies in local areas. This type of lending is increasingly common and may be in cash or kind.

The private moneylender is characterized by diverse, flexible operations. Their loans usually are small scale as well as short-term (specified by season or by days). The loan rates are determined by market principles, usually ranging from 3% to 10 % per month.

Ho/Hui, are popular forms of ROSCAs in Vietnam, that have existed for generations but have never been officially recognized. *Ho* derives from the word 'relatives' and is a credit and saving group of 5 to 20 people. Each group works independently and separately from other groups. *Ho* is popular in the North while *Hui* (almost the same working mechanism but different name) is in the South. *Ho/Hui* are voluntarily established by a group of individuals. They mobilize savings members and provide loans only to members. Decisions on interest rates, membership, and loan amounts are either made jointly by all members, by a bidding process, or solely by the organizer/owner of a *Ho/Hui*. Interest rates determined by bidding are popular. There are two common types of *Ho/Hui* including "credit type" and "supportive type". The former participants aim to earn additional income from interest, while the later aim to mutual assistance among participants.

It is remarkable that no foreign NGOs seem to have taken the existing *Ho/Hui* as models for designing their own microfinance schemes. The typical NGO scheme will decentralise decisions about who in particular will get loans, but often not much else (the interest rate, the purpose of loan, the loan period, the loan size). The arguments for keeping such policies centralised, if discernible at all, are mostly related to a microfinance-as-charity vision that tries to ensure that the credit is cheap and that it gets to the poor.

The PCFs are a type of credit cooperative. Credit cooperatives have a long history of development over the last 30 years in the North and the last 10 years in the South. By the end of 1985, there were 7,100 credit cooperatives operating throughout the country, but during the late of 1980s the system of credit cooperatives fell into crisis. The lack of a formal regulatory framework, including the absence of implemented prudential regulations, led to mismanagement, corruption and closures. The lesson learned was that a clear and enforced regulatory environment is essential for the finance sector, even microfinance, but movement towards developing such an environment has been slow.

The PCFs were first established in 1993. They are modeled on the *Caisse Populaire* system in Quebec, Canada. The PCFs are commune-based rural credit institutions that provide financial services to local farm households. By 1999, the system of PCFs comprised 981 funds operating at the communal, regional and central levels, with around 630,000

memberships.

Apart from state-owned banks, there have been a large number of shareholder banks in Vietnam, including 51 joint stock commercial banks. Of the joint stock commercial banks, there are 31 banks operating in the urban areas and 20 banks operating in the rural areas. Almost all-rural joint stock banks had been restructured from rural credit cooperatives. Although set up by share subscription from their members, the Government now keeps 10 percent of the shares of rural joint stock banks. It is estimated that about 10,000 rural households are customers of RSBs

The Ministry of Labour, Invalids and Social Affairs (MOLISA) and the Ministry of Agriculture and Rural Development (MARD) operate a variety of microfinance schemes. The largest are to support reforestation and job creation. They involve highly subsidised lending requiring repayment, although anecdotal information suggests a high level of defaults. The job creation scheme, for example, aims to help individuals and households develop their production to create new jobs. The program has lent 1,070 billion VND (\$75 million). Loans are for up to 36 months with 0.6 percent monthly interest. The program has benefited nearly 50,000 clients. Similarly, the MARD program for reforesting five million hectares provides credit with free or low interest rate (7 percent per year) to farm households for reforestation activity.

Box 2: The fungibility of capital

A “fungible” thing is one which “precisely or acceptably replaces or is replaceable by another item” (*The New Shorter Oxford Dictionary*, p.143). The use of cash is highly fungible. Which 10,000 dong note is used for lunch and which one for buying a pen does not matter. Yet many banks and donors insist that their loans be used for specific purposes, typically for some productive activity. Yet the loan is adding to what the household had anyway, so it is really only paying for whatever extra activity the household (or the country) undertakes *that it would not have otherwise done* – which may not be a productive activity.

For example, farmer Hien has one million dong in savings that she is going to use to buy pigs, but she also wants and would like to borrow 500,000 dong for her daughter’s wedding. Maybe she cannot get a VBP loan for a wedding, so she borrows 500,000 dong towards buying the pigs and can then spend 500,000 dong of her savings for the wedding. The extra activity, the wedding expenditure, is what the loan allowed.

At the microfinance workshop, 34 of 64 reporting participants said that multiple-lending (i.e. more than one loan at a time) by rural households was “evident, but not very common”, while 20 others thought it “common practice”. Multiple loans offer more scope for juggling the use of funds. They may also, however, be an indicator of financial arbitrage activity, as discussed below.