Notes from Preliminary Review on Micro-finance for Poverty Reduction in Vietnam[1]

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[1] The author prepared this preliminary review from official and unofficial documents and reports, and informal discussions with people experienced and knowledgeable in the field. Comments are welcome.

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1 Background on the Micro-finance in Vietnam

Vietnam remains one of the poorest countries in the world with a poverty rate of 29 % in 2002 compared to 37 % in 1998 and 57 % in 1993. Steady reduction of poverty is a remarkable accomplishment. The Central Highlands is the poorest region in the country (51.8 %), followed by the Northern Mountains and North Central Coast (43.9 %)[2]. For the poor, widespread and regular access to loans at interest rates somewhat below those charged by private lenders would be of great value. The rural financial sector in Vietnam presently has three sub-sectors: formal, semi-formal and informal[3]. All of these sub-sectors have provided poor households with micro finance services in different forms and approaches. The Vietnamese microfinance market is rather fragmented and in some places overlapping. This fragmentation has resulted in some specific concerns about the extent to which subsidized operations will undermine the sustainability of the MF sector and generate potentially large fiscal liabilities in terms of loans and deposits in the system. Given mixing access to finance with charity, some MF providers failed to provide MF services with an eye to financial sustainability. In this context, a small percentage of the poor get cheap credit while the remainder is left to deal with moneylenders or have no access to MF.

Data from the 2002 Vietnam Living Standards Survey (VLSS) showed that 32.6 % of surveyed rural poor households and 31.4% of surveyed urban poor household were in debt. Table 1 indicates that the Vietnam Bank for Social Policies (VBSP) played a dominant role in providing credit to poor households with loans to 58.3% of the surveyed rural poor households and 53.9% of the urban poor, followed by the Vietnam Bank for Agriculture and Rural Development (VBARD) (23.8% of the surveyed rural poor & 19% of the urban poor), and then political – social organizations (7.0% and 15.6% of the rural and urban poor respectively). The commercial banks did not demonstrate a significant role in lending to the poor because only 1.1% of both urban and rural households reported loans from other banks. The loan size from most sources for the urban poor is relatively larger than the loan size offered to the rural poor.

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

	Loans (%)(*)		*Loan Size*			
	Rural	*Urban*	*Rural*		*Urban*	
			(1,000VND)	*USD*	*(1,000VND)*	*USD*
Formal financial sector						
VBSP	58.3	53.9	2,498.5	159.1	2,555.2	162.8
VBARD	23.8	19.0	3,720.4	237.0	4,760.4	303.2
PCF	2.9	2.7	2,642.8	168.3	4,192.4	267.0
Other Banks	1.1	1.1	2,957.4	188.4	5,542.9	353.1
Semi-formal sector						
Political & social organizations including NGOs	7.0	15.6	1,603.2	102.1	1,899.7	121.0
Informal financial sector						
Relatives, friends	6.7	5.9	2,598.8	165.5	5,104.5	325.1
Money lenders	4.1	3.5	2,567.6	163.5	2,012.3	128.2

Source: Vietnam Living Standard Survey (A nationwide sample survey), 2002

Note (*): *This column shows the percentage of the surveyed households which reported taking loans from each source. Column does not total to 100.0% because some households took loans from more than one source.*

[2] Statistics from the Development Report 2004 by the World Bank, the poverty -line is one dollar per day per capita.
[3] Information from the NGO Micro-finance Programmes in Vietnam by Save the Children Japan , 2003

2 Main Findings

2.1 Formal sector

The formal sector includes activities provided by financial institutions operating under the law on Credit Organization (the banking law of the State Bank of Vietnam and the Law on Cooperatives). Rural finance in Vietnam is largely dominated by the Vietnam Bank for Agriculture and Rural Development (VBARD), the Vietnam Bank for Social Policies (VBSP) and the People's Credit Fund (PCF). Profiles of these institutions will be provided in the subsequent section. All of these institutions are supervised by the State Bank of Vietnam (SBV). They have extended their network throughout the country and provided loans to the poor with subsidized interest rates. These institutions have reached impressive scale but have not utilized the techniques of MF that would allow them to reach poorest clients, especially women (Plan International: 2003).

2.1.1 Vietnam Bank for Social Policies (VBSP)

The Vietnam Bank for Social Policies is the successor of the Vietnam Bank for the Poor. Changed to the new name in 2002, the Bank is authorized by the Government to provide concessional credit to the poor and other social policy beneficiaries. The social policy beneficiaries can be disadvantaged students studying at universities, colleges or vocational schools; migrant workers returning home from a limited term contract; and economic organizations or productive households in remote and mountainous areas. The VBSP is presently the primary formal lending institution explicitly targeting the poor. The Bank gets its money from its legal capital, loans funds under the programs for poverty reductions, job creation, and other social policies, funds deducted from income surplus, fiscal expenditure savings, ODA funds delegated by the Government and savings from various sources. It began operations in March 2003 and concentrates its lending activities on poor households certified as such by local People's Committee. The VBSP provides loans to the poor with subsidized interest rate through group arrangements. The group has joint liability for the loans and poor households do not have to post collateral. They can borrow up to 7 million VND ($446) for 1-5 year maturity and at interest rate of 6.0 % per year. The terms of the loans are flexible and generally include monthly or quarterly interest repayment. The loans can be used for variety of purposes, including the purchase of business inputs, house construction and improvement, electricity connection, clean water facilities, and partial educational coverage. The repayment rate of VBSP is not yet clear. As a new institution, VBSP has insufficient credit risk and management skills as well as limited internal audit and reporting systems, which may produce difficulties in accurately monitoring the bank's outstanding loans[4]. Due to subsidized interest rates, the Bank is not financially sustainable.

2.1.2 Vietnam Bank for Agriculture and Rural Development (VBARD)

Apart from the role of a commercial bank, VBARD has provided credit access to 35.1% of low-income households in 2001. It is the largest partner for the international credit projects supported by World Bank (WB), Asian Development Bank (ADB) and German Bank for Reconstruction (KFW). VBARD accounted for 60 % of the total number of loans with average loan size of approximately 6.45 million VND. The loan size can be up to 10 million VND ($637)

[4] Statistics from Development Report by the World Bank, 2004.

without collateral if the applicant is sponsored by either the Women's Union or the Farmers Association, which is jointly responsible for servicing the loans. The terms of the loans is typically 6 months and renewable for another 6 months with annual interest rates in the range of 6.0 % to 14.4 % but it can fluctuate with the market. Repayments take different formulas from lump sum to regular installments. Debt rescheduling is not uncommon but a lower interest rate applies to arrears. Less than one third of the loans are non-performing in poor communes (World Bank:2004).

VBARD has some underlying weaknesses such as:

- Unofficial fees for borrowers such as application form (5,000 VND), stamp from local authority (500-5,000 VND), traveling (10,000VND per return trip)...increase client costs when applying for loans.
- The Bank hasn't yet targeted the low-income farm households.
- The Bank's services have not covered as many rural areas as expected.

2.1.3 People's Credit Fund (PCF)

According to Save the Children Japan (2003), the PCF is a strong partner to implement the rural credit project funded by ADB. It is a self-managed, small-scale and communal level financial institution. PCF is a form of credit cooperative and it has extended its network to the communal level. It plays a role of an intermediary financial institution to increase financial access for both rural depositors and borrowers for primary purpose of income generation. Up to June 2002, there were 889 local PCF and 21 branches of central PCF operating throughout the country. The PCF's financial sustainability is based mainly on savings from its clients. The PCF's average loan size is around 4.5 millions VND ($287) for 6-12 month terms: 58 % of loans were used for agricultural production, 27 % for commercial purposes and services, 12 % for processing of agricultural products, and 3 % for consumption (Dao, H. et al:2002). The annual borrowing rates are in the range of 10.8 % to 15 %. By 2002, the system provided financial services to around 7.5% of rural households.

2.2 The semi-formal sector

The semi formal sector includes governmental organizations (GOs) and non-governmental organizations (NGOs). The GOs' MF schemes include national programs and schemes operated by professional MF providers. The main source of support for the national programs (Job generation program; Greening program for barren hills and unused land; National program for reforestation of 5 millions hectares; and National program for poverty alleviation) comes from State budget. Micro-credit is designed as a component of these programs in order to achieve various higher-level objectives. These national programs provide loans with highly subsidized interest rates (from 1.2 % and maybe up to 3.6 % per year) or even without interest rate. Most of the loans have 3 year or longer terms.

The MF schemes operated by professional MF institutions are programs run by Capital Aid Fund for Employment of the Poor (CEP) working under the umbrella of Ho Chi Minh City Labor Confederation and TYM (I Love You Fund) under Central Women's Union… The subsequent sections will provide greater details. In addition, up to October 2003, there were 57 NGO[5] running MF programs in Vietnam. They have applied various models in their programs that are mainly Grameen Bank, Village Banking or Social Group models. Most of the NGOs'credit programs have targeted poor women.

Through informal interviews and discussions, it is noted that there are two outstanding professional MFIs, that both follow Grameen Bank model, namely CEP and TYM. These two institutions provide MF services to the poor in rural and urban areas successfully and make great efforts to be financially and institutionally sustainable.

2.2.1 TYM Fund

The Vietnam Women's Union (VWU) started the TYM fund (Vietnamese version of I Love You Fund) with the assistance of Dr. Jaime Alip, a FAO credit adviser in August 1992. This fund aims to provide credit to poor women for income generation and improve knowledge of poor women through weekly exchanges sharing. TYM has become a member of a big family of Grameen replications. TYM operates under the Vietnam Women's Union and Presidium. Its structure includes:

Head office in Hanoi

Branch office at the district level

Center (6-8 groups)

Groups (5 members)

To date, TYM has 19,255 clients with balance of outstanding loans amounting to 34 billions VND ($2,165.605). TYM has been operating its programs in both urban and rural areas of 7 provinces including Hanoi, Vinh Phuc, Hung Yen, Hai Duong, Nam Dinh, Nghe An and Thanh Hoa with 15 branch offices, of which 8 break even. TYM provides different types of loans but one type targets income generation, which is general loan (2,000,000 VND or $127) to be repaid within 50 weeks in weekly installment with the annual interest rate of 12 %. In addition, TYM has individual compulsory saving including weekly saving of 3,000 VND ($0.19) and from 5% of every loan when each member receives a loan. TYM also has voluntary saving to mobilize savings and idle money from its members at weekly meetings with monthly interest rate of 7.2 %.

TYM is currently coping with a number of challenges:

- Legal status: as a department of VWU it is not easy for TYM to borrow money from banks. TYM is considering the proposal for being separated from VWU as a special social fund to operate MF activities. However, nobody is sure that VWU will approve.

[5] NGOs mean international NGOs.

- TYM does not use staff of Women's Union to run its activities at the district and commune levels as other MF-MF programs operated under VWU. This is an advantage but its staff need to strengthen their professional skills.
- Information system: most of record keeping is manual.
- Lack of exposure to other successful credit schemes both domestically and internationally.

2.2.2 The Capital Aid Fund for Employment of the Poor (CEP)

Since the Ford Foundation has had a number of contacts with CEP, this report will present an update as well as some outsiders' views about the institution. Founded in 1992, CEP is a non-profit organization operating under Ho Chi Minh City Labor Confederation as authorized by a decree of the People's Committee. To date, CEP has had 53,181 clients in 24 urban, semi-urban, and rural districts of Ho Chi Minh City; around 74% of them are women with a per capital daily family income of $0.75. CEP currently provides small and medium size loans up to $ 205 with annual interest rate between 9.6% and 30%. The average first time CEP client will receive a $95 loan at an annual interest rate between 9.6% and 12%. CEP is considered as a professional and leading MFI in Vietnam. In comparison with TYM, CEP is more flexible and independent from its umbrella of HCMC Labor Confederation. This gives CEP a stronger position in operating its activities. AusAID remains the biggest donor to CEP through a 5 year project with $3.3 million. Part of this support focuses on building CEP institutional capacity. CEP organizes its activities under the leadership of the Board of Directors according to the following structure:

Head Office with Departments in HCM City

↕

Branch (14 districts)

↕

Center

↕

Group

Some highlights of CEP strengths from its own business plan & comments from its donor and other experts:

- Strong local and international support networks.
- Operationally and financially strong.
- Dynamic leadership with specialized and strong individual staff.
- Open to support CEP replication both internally and externally.

In addition to its strengths, some areas for further improvements remain with CEP:

- Human resource capacity to keep pace with expansion, especially the second level of management.
- The rural poor in other provinces remain out of CEP's current outreach MF services.

- Lack of a comprehensive IT environment to manage the expansion

2.2.3 MF activities run by international NGOs

Most MF activities run by NGOs have been used an effective tools for poverty alleviation and empowerment for the poor. Most programs have targeted poor women and have worked in partnership with local Women's Union at different levels. From the research study conducted by Save the Children Japan in 2003, eight of the fifteen MF programs considered commune level as direct management level and in the rest of the studied programs the district level was the management level. In most of the programs, savings and credit took place through small borrowing groups on a voluntary basis for easiness in establishment, meeting and management, and close relationship among group members. The most common loan product is the common loan with an amount of one to several million VND($100 or $200) with the terms of 12 months. Around 65 % of the loans were used for livestock raising compared to 16 % for small business and 12 % for farming. The rest was used for different purposes. The most common repayment mechanism is monthly installment for repayment of principle plus interest. This mechanism ensures high level of repayment and reduces the risk of loan loss. However, the collection installment takes more time and costs in terms of book keeping and administrative work.

As previously outlined, interest rates are set at a level the program implementers think will cover all costs to ensure their sustainability. Save the Children US and Action Aid Vietnam are two organizations, which have good MF models with regards to financial sustainability. One of the biggest challenges for them is how to sustain these programs institutionally for further expansion. This will be determined through the new decree on microfinance if it is soon approved.

The MF programs run by NGOs are still attractive to the poor because of their non-collateral borrowing mechanism through guarantee groups and availability at the commune and village levels with simpler procedures. These programs provide opportunity to borrow money more than one time, for example in Action Aid Vietnam and Save the Children UK people have borrowed continuously ten times with one-year loan cycle. In addition, apart from taking part in borrowing and saving money, members had opportunities to join other integral activities such as agricultural promotion, nutrition, health care communication, pre-school education, reproductive health care and other topics.

The MF activities operated by NGOs are considered as a useful tool to change the livelihoods of the poor and have significant impacts on income, assets, life quality, knowledge, confidence, and prestige in the commune. In addition, these program have contributed actively to improving women's role and capacity: firstly they have access to loans for developing business and production; secondly women can improve their awareness, knowledge, and experience of business and information through training and weekly and monthly group meetings; finally women can participate more in decision making related to the loans, the direction for production, money usage and in family issues and social activities.

Nevertheless, a number of difficulties and challenges remain with NGO supported MF programs:

- Lack of legal framework for professional MFIs such as mobilization of both public and member savings as well as determination of directions for future.
- Part-time and non-specialized staff as constraints to commitments of time and responsibility.
- Lack of a common standardized accounting system for accurate finance analysis and sustainability.
- Some MF programs are financially unsustainable because they are designated to temporary social targets and transfer funds to non-financial purposes.

2.3 Informal sector

The informal sector continues to be of great importance in the provision of MF in Vietnam with moneylenders, relatives, friends, and rotational savings and credit associations (ROSCAs). The informal sector accounts for around 50 % of the total micro-credit market (World Bank: 2004). Nevertheless, the Vietnam Living standard Survey 2002 (VLSS) shows that the poor have limited access to the informal lending (4.1 % of the rural poor households borrowed from money lenders and 6.7 % reported to have loans from their relatives and friends).

Moneylenders who are better off families in rural areas often provide credit in different terms (on seasonal or daily basis). As estimated, there are 2-3 people permanently providing this type of service and 5-10 people on a seasonal basis in each village (Dao, Hung et al: 2002). The repayment is often made in cash, but in some cases rice, buffalos, furniture… are also accepted. Loans from friends and relatives take flexible forms, normally without interest rate, which depend greatly on the relationship between borrowers and lenders, or income source of borrowers. The poor are often isolated from this type of lending due to some social prejudice: "*better to donate the poor some lump-sum rather than lend them money to maintain a good relationship in the future*" (Dao, Hung et al: 2002).

In addition, there exists a type of rotational credit and savings associations (ROSCAs). The first form of ROSCAs, that is, "ho" (in Vietnamese) was originated from the Northern region from friends and relative: each association consists of 5-20 members. Association members often do the same job as farmers, small business people, and veterans. Members deposit savings with the leader of the association so that each member can take turn to borrow money. Savings are in the form of cash in the range of 50,000 VND ($3.5) and 1,000,000 VND ($63.7) on the monthly basis or in-kind form such as rice for farmers on seasonal basis (4-6 months). The second form of ROSCA, namely "phuong", provides loans without interest rate. Each association comprises 5-8 members who are required to deposit savings on a regular basis and then they take turn to receive a loan in a credit cycle. This form is relatively popular for ethnic minorities in mountainous areas where loans without interest rates are considered as a favorite form of self-help.

Borrowing interest rates in the informal sector are much higher than the formal and semi-formal sectors, which can be 4 % per month and can reach as much as 10 %. There are several explanations for persistent high interest rates in the informal sector (McCarty, A., et al: 2001):

- High risks (no collateral)
- Remoteness limiting choices

- Restrictions on formal loans limiting access
- Small loan sizes
- High transaction costs per VND lent

2.4 Four popular models of delivery of credit services in Vietnam

Table 2 presents four models of delivery of micro-credit services. These models have been applied by a number of institutions in the formal and semi-formal sectors with statistics about the total number of clients, interest rate, loan size and working locations.

Table 2: Some examples of statistics from MF institutions in the formal and semi-formal sectors

Micro finance institutions	Total # of Borrowers	Annualized Interest Rate (%)	Loan size (VND)[6]		# Provinces
			Minimum	**Maximum**	
Formal Sector (leading MF institutions to the poor)- Formal model by the end of 2001					
Vietnam Bank for Social Policies (VBSP)	2.5 million	6-13.8		7,000,000	Throughout the country
Vietnam Bank for Agriculture & Development (VBARD)	2.5 millions	10.8-13.8	1,000,000	10,000,000	Throughout the country
People's Credit Funds (PCF)	630,000	10.8-15	Average loan of 4,100,000 VND		Throughout the country
Semi Formal Sector - Grameen Bank Model in 2003					
CEP	42,132	9.6-30	1,000,000	7,000,000	HCM City
TYM (under Women's Union)	19,255	12	500,000	1,000,000 - 15,000,000	7
Vietnam-Belgian Credit Project (Women's Union)	50,182	12	800,000	3,500,000	17
Action Aid Vietnam	29,248	14.4-18	100,000	5,000,000	5
CIDSE	4,168	18		3,000,000	7
Semi formal sector - Village Banking Model in 2003					
SNV	6,669	14.4		2,000,000	Quang Binh
Plan International	273	18		1,000,000	2
IFAD	21,189	10.8		3,000,000	Ha Tinh
Semi formal sector - Social Group Model in 2003					
Save Children US	6,000	18-24	300,000	3,000,000	2
ADRA	332	12	1,000,000	2,000,000	Quang Ngai

Sources:

- *Report on NGOs' Micro finance Programmes in Vietnam by Save Children Japan (SC Japan) and Japan Bank for International Cooperation (JBIC) in October 2003*
- *Planet Finance*
- *Diagnosis of access expansion for low-income households to formal financial institutions in Vietnam in 2002*

[6] Exchange rate: $1 equivalent to VND15,700

2.4.1 Formal banking Model

The formal banking model like commercial lending is applied by the banks in Vietnam including the three above leading banks (VBSP, VBARD & PCF) providing loans to the poor. For the poor, collateral are not required but some cases, they need to submit certificate of being poor issued by local authorities. Through this model, borrowers have to approach banks with their request for loans. Then, they have to complete borrowing procedures including filling in the form with approval from the local authority. Once the banks receive the completed dossier/form from their potential clients, credit officers are in charge of checking the dossier as well as the potential clients, their business plan, requested loan size with interest rate and terms. The chief credit officer will then cross-check the dossier and request further assessment if necessary before proposing the request for loans for approval. The director of the branch bank will check again the dossier and finally approve the request for loans with interest rate and terms. The bank accountant will be approved to prepare a contract for loan disbursement. The annual interest rates are in a range of 6 – 15%, borrowers are required to repay on the yearly basis or at the end of the terms.

2.4.2 Grameen Bank Model

The Grameen Bank model was originally developed by the Grameen Bank in Bangladesh to support rural women for income generation activities. This model is very popular in Asia and some other places. Typical examples of this model include Grameen Bank, Commission for Rural Progress in Bangladesh, Tulay sa Pag-Unlad, Inc; Dungganon Project in Philippines; Sahel Action in Burkina Faso. In Vietnam, a number of organizations, for example, CEP, TYM, CIDSE, Action Aid… have also applied this model. The model is based on the structure: at village level each group is formed with 5 members without any familial or marriage relations; and then a center is established with 8 groups. All members are required to participate in weekly meetings which are also the time for them to deposit savings, contribute to their group's fund and pay insurance. All the group members work on basis of trust and guarantee other members' loans. Members are allowed to borrow loans without collateral. The loan sizes are between $100 and $300 for 6 - 12 month terms with approximately annual interest rate of 20 %.

2.4.3 Village Banking Model

The village banking is the model of community managed credit and savings organizations to provide financial services in rural areas, establish self-help groups at community level and help members accumulate savings. This model was developed in middle 1980s by International Community Support Organization (FINCA). In Vietnam, some international organizations have applied this model such as Netherlands Development Organization (SNV), Plan International and International Fund for Agricultural Development (IFAD). A village bank comprises about 30 to 50 members; most of them are women. This model introduces a structure consisting of individual members and a management board. All the members have to sign an agreement to borrow loans to ensure a common guarantee. The total loan request of the village banking is the total of loans requested by individual members. Each member normally starts with a small short-term loan (4-6 months). Repayment is made by weekly equal installments. Loans provided from internal accounts are short-term with higher interest rates. Weekly and monthly meetings are organized to collect savings, provide loans, and discuss management issues. Loans are often given with commercial interest rates (12-36% per year).

2.4.4 Social Group Model

The social group model was developed by ACCION International in Latin America Replications of this models have been made by branches of ACCION: PRODEM, Bancosol Bolivia; Asociacion Grupos Solidarios de Colombia; and Genesis and PROSEM in Guatemala. In Vietnam, Save the Children US, Adventist Development and Relief Agency International (ADRA) and some other international NGOs have replicated this model. Through this model, loans are provided to groups of 4-7 members on the basis of trust to replace the collateral mechanism. Clients are often women who run small business in markets who have a need for small and flexible loans. Loans are repaid at the program head office. Minimum technical training and institutional strengthening are provided to borrowers. Each credit staff member is usually in charge of managing 200-400 clients. The loan size is decided by the credit officer based minimum economic analysis required for each loan request. Loans are approved by heads of branch offices, and credit officers make visits to individual clients. Members receive loans with an equal size, size of subsequent loans can be flexible. The subsequent loan size and terms are increased if clients demonstrate their ability to receive larger size loans. The initial loan size is around $100 with relatively high interest rates; for example in Vietnam the annual interest rates are between 12 and 24 %. Savings are compulsory as part of the loans.

2.5 The MF working group (MFWG)

Given the context in which MF activities in the semi-formal sector were still in need but lacked a legal framework for professional MFIs, both expatriate and local experts clearly saw the demand for setting up a working group in order to promote mutual learning and exchanges. As a result, a micro finance working group (MFWG) was set up in April 2004. This MFWG presently have 66 members from around 38 organizations, of whom 11 are core group members. The MFWG is open to anyone who is interested in MF in Vietnam. The main activities of the group include:

- Information exchanges through listserv under the UNDP website with the facilitation of Plan International and Save the Children US.
- Monthly meetings.
- Bulletin publications (twice per year)

The MFWG is an informal living resource center for MF and a focal point to provide inputs to policy making level. Nevertheless, given the fact most of the members are busy with individual commitments, the working group will be unstable when an expatriate member leaves Vietnam, for example, or a local member moves to another organization to work. Some committed members, especially core group members have ambitions to:

- Make the bulletin more valuable and stable.
- Establish a training center or resource center to capitalize and disseminate knowledge and best practices in MF.
- Facilitate study tours both domestically and internationally to learn from other best practices.

2.6 Legal issues

2.6.1 Legal framework

The MF services have been influenced by four laws namely: *the Civil Law in 1995, the Law on Cooperatives in 1996, the Law on the State Bank and the Law on Credit Institutions in 1997*. These laws regulate not only the activities of the formal credit organizations but also banking activities of all informal organizations. *The Civil Code* clarifies rights and obligations with regards to private lending and borrowing and emphasized that private lending interest rate cannot exceed 150% of the officially published interest rate. Most of the semi formal credit programs have chosen to follow the Civil Law. *The Cooperative Law* provides a framework for the development of credit cooperatives for signing business contracts with other organizations, opening an independent account at banks, applying for loans from formal credit institutions, and providing inputs for policy making. *The Law on Credit Institutions* introduces registration of non-credit institutions with banking activities for the poor and the disadvantaged with support policies by the Government in terms of capital, interest rate and lending conditions. Social organizations are allowed to provide loans to their members but not to mobilize non-fixed term savings and provide payment services.

2.6.2 Interest rates

The Governor of the State Bank of Vietnam (SBV) promulgated a decision # 546/2002/QD-NHNN on May 30, 2002 on a negotiable frame of interest rates for the Vietnamese currency for credit organizations to deal with their clients. Based on this decision, credit organizations can determine interest rates for their clients by identifying demands for market loans and level of a bank's credibility toward its clients including Vietnamese legal institutions, individual or foreign institutions and individuals working in Vietnam. The State Bank of Vietnam continues to make public basic interest rates with a reference to interest rates offered through commercial lending of credit organizations to their best clients. For example, the lending interest rate that Nam A Joint-Stock Bank, a commercial bank, offers its best clients is 15.6 % for short-term loans, and 16.8 % for medium term loans. The interest rate policy also requires that the difference between lending and borrowing interest rates cannot be greater than 0.35% for short-term loans and 0.5% for long-term loans. The basic interest rate frame is published in Nhan Dan Newspaper (People's Newspaper) on the first day of the month. To date, to ensure the sustainability of their programs each semi-formal credit organization (social mass organizations and NGOs) can set interest rates 30 or 50% higher than the rates the VBARD offers its borrowers.

2.6.3 Savings mobilization

People who are poor or geographically isolated are disadvantaged in savings activities because the formal sector banks, for example the VBARD, do not accept deposits under 50,000 – 100,000 VND ($3.5 - $6.4). In January 2000, the Government of Vietnam issued an official letter No. 209 to allow the Women Union to continue savings activities for the sake of poverty alleviation. However, NGOs and other mass organizations have not achieved the same legal status to mobilize savings though they are still doing it.

2.6.4 The draft decree on the organizations and operation of MF organizations in Vietnam

Given the situation that semi-formal sector microfinance institutions lack a legal framework for their activities, the SBV requested the Asian Development Bank for support to draft a legal framework for MF in Vietnam. The draft decree proposes that Vietnamese NGOs and social organizations be allowed to establish MF organizations in Vietnam with a maximum duration of 10 years with an Operation License offered by the SBV. The legal capital for Vietnamese MF institutions shall be 500 million VND ($31,847) for those who wish only to mobilize member savings and 5 billions VND ($318,471) for those who wish to mobilize voluntary savings. The MFIs are to provide short, medium and long term loans to low income individuals, households and members of MFIs for the purpose of production and business development for the community interest in accordance with the provisions of the SBV. The MFIs may raise funds from savings deposits from their borrowers and/or term deposits from domestic organizations, or borrow funds from credit institutions, foreign individuals and organizations as permitted by the SBV based on the level of their legal capital as above. The MFIs are allowed to be established at the provincial and district levels but not at the national level.

There may be soon the opportunity to establish formal MFIs in Vietnam if the above legal framework is finalized. Most of the current local experts in MF are accustomed to the Vietnamese way of doing MF and lack an international perspective. When the decree passes, the local experts would benefit greatly from international expertise and consolidate their current activities strategically (Plan International:2004). Moreover, the legal framework will be of great support to MF programs previously operated by some INGOs such as Action Aid Vietnam, Save the Children UK or Oxfam Great Britain. These organizations handed over their MF programs to local authorities and communities due to the cut-back of donors' financial support or the global or regional change of focus in the field of MF. For example, the MF programs of the Action Aid Vietnam is currently focusing on the most vulnerable groups including people living with HIV, sex workers, poor migrants in big cities, at the same time it is making efforts in advocacy for the formal MF sector to better serve the poor and the poorest. Their community based MF programs in a number of provinces including Son La, Lai Chau and Ha Tinh have been handed over either to district people's committee and women's union (the case of the MF program in Son La province) or to a nascent local NGO established under the law for Social Charity Fund under the supervision of provincial people's committee (the case of Ha Tinh program).

The decree could be submitted to the director of SBV for approval as early as the end of September 2004. It is expected that a final decision will be made by the Government very soon. For the time being, the decree is focusing exclusively on rural credit and compulsory savings. MF experts have been very active in contributing their inputs to revise the draft decree. If any additional comments might arise after the decree is passed, revisions then will be made as committed by the SBV as lessons learnt from experience. In three to fives years, Vietnam will need new legislation to enable the development of other MF services (MFWG: 2004).

3 Recommendations

Reflection on key principles of MF

CGAP is the Consultative Group to Assist the Poorest. This is a World Bank-led consortium of donors and organizations supporting successful microfinance institutions and the collection and diffusion of "best practices" in microfinance. The Ford Foundation is a member of this Group. The Group has identified “best practice” in microfinance, from which they have derived these principles:

- The poor need a variety of financial services, not just loans.
- MF is a powerful instrument against poverty.
- MF means building financial systems that serve the poor.
- Financial sustainability is necessary to reach significant number of poor people.
- MF is about building permanent local financial institutions.
- Micro credit is not always the answer but other forms of support before they can make use of loans.
- Interest rate ceilings can damage poor people’s access to financial services.
- The Government’s role is as an enabler, not a direct provider of financial services.
- Donor subsidies should complement, not compete with private sector capital.
- The lack of institutional and human capacity is the key constraint.
- The importance of financial and outreach transparency.

These principles have proved helpful in considering what are the priority needs of the MF field in Vietnam. Here are some areas of positive interventions:

3.1 Legal framework for MF in Vietnam

- Support MFWG as a focal point in order to advocate with the Government to speed up the process of finalizing the new decree on MF in Vietnam as well as revision of the decree after it is approved with lessons learnt from experience and practice.
- Support some professional institutions such as CEP, TYM, Save the Children US or Action Aid in implementing best MF models for uplands, rural and urban poverty alleviation. These can be vivid examples to give valuable inputs in the process of finalizing the new decree in MF.
- Possible research study on the new decree on MF - what does the new decree mean for micro-finance in Vietnam and/or what help would be required to implement this new decree.

3.2 Professional institutions in the semi-formal structure

MFIs in the semi-formal sector such as CEP or TYM might not require financial support from a private donor for their on-lending activities but support might be helpful in the following areas:

- Capacity building (both human resource development and institutional building), specifically in-depth technical and professional training related to MF such as market and financial analysis or advocacy skill to decision making level.

- Information management systems for these institutions.
- Support CEP & TYM in providing professional training in MF to other institutions in Vietnam through their training centers.
- Interventions of CEP & TYM in rural areas as best practices for replications in rural and mountainous areas.

3.3 Banks in the formal sector

The formal sector has received great support from international donors, especially multilateral donors such as World Bank and Asian Development Bank. In order to make the banks' services more available and accessible to the poor and the disadvantaged, the following recommendations are proposed:

- Support possible pilot interventions between MF professional technical providers and the banks by strengthening the Vietnam Bank for Agriculture and Rural Development (VBARD) and the Bank for Social Policy (BSP) through support in management and training of vital bank staff; improving the openness of bank staff and other key personnel at the district level to serve the poor; at the same time stimulating bank policies towards the poor as an interesting market segment for their credit portfolio.
- Support to advocate the central level (Vietnam State Bank) with outcomes of pilot interventions.

3.4 Micro-finance working group (MFWG)

- Support the MFWG to become more formal learning and advocacy group with long term commitments from participating organizations.
- Support the MFWG's bulletin to make it more stable, valuable and practical to practitioners and experts in the field of MF.
- Support the MFWG to set up a practical and valuable resource & training center for MF in Vietnam with its business plan to ensure its sustainability both financially and institutionally.
- Possible joint research on how MF really helps people at deeper level of poverty in Vietnam?

4 Informal Group Discussion

To validate the findings and conclusions from previous interviews and document reviews, a discussion was held at the Ford Foundation office with five experts in the field of MF from the State Bank of Vietnam and other implementing and technical support agencies. The discussion was framed on the following issues:

4.1 Who are "the poor?"

Most of the MF semi-formal sector programs operate in rural areas according to the participants because the poverty rate there is higher than in urban areas and the formal sector provides its services more strongly in urban areas. Apart from CEP in HCM City, which provides the urban poor with MF services, and Save the Children (US) in Dong Anh, a semi-urban district of Hanoi, there are no other international MF institutions in urban areas.

In Vietnam, some organizations have used the CASHPOR Housing Index to select the poor for their MF activities. The CASHPOR House Index (CHI) is an external, observational methodology which provides a cost-effective way to identify very poor people in most conditions throughout rural Asia. It is an adaptation of the Grameen approach to poverty targeting. Since housing is generally the most important asset of households and since people generally invest a great deal in their houses, the building itself represents an extremely visible reflection of household wealth. Basically, this methodology uses indexes for the size of the house, its structural condition, the quality of walls, and the quality of the roof. Each index is coded for later rapid appraisal.

In addition, some programs use the method of participatory wealth ranking (PWR) to identify the poor. The PWR has been developed by the Small Enterprise Foundation. The PWR relies on criteria that communities themselves define to conduct assessments of who within their communities they deem to be poor and who is relatively better off. The PWR draws on the experience of two decades of participatory appraisals of academic researchers and development workers who have used it successfully to both generate insights into the dynamics of poverty as well as collect detailed community information at low cost. The PWR lets communities themselves define what constitutes poverty and relative well being and lets communities then classify households according to relative levels of poverty.

4.2 What are the barriers to the further development of the MF field in Vietnam?

MF institutions do not have legal standing so they can't expand to meet the needs of poor communities. Thus, for example, the Women's Union MF schemes have no independent legal status, while at the same time VBARD holds $32 million earmarked for on-lending to MF institutions which it can't legally disburse. Without legal standing, MF institutions also cannot mobilize and hold voluntary savings nor insure for risk.

MF can build community solidarity by exchange of information within the community. MF is mostly about access and continuity. VBAR and SPB however are interested only in lending for assets that directly produce cash flow. In fact, MF savings (and insurance) are more important than just credit by itself, i.e., the MF field needs to provide the poor with comprehensive financial services.

MF schemes target everyone in a geographical area as "poor." Consequently anybody can join and membership in MF schemes fluctuates; people drop in and drop out. If you target the real poor however, repayment rates are high.

International NGOs finance a revolving fund in a province, district or commune. However the monies are considered a part of the state budget, i.e. they belong to the province. It is ambiguous what happens to the INGO revolving fund when the project ends, or who actually owns the members' accumulated savings.

There are no longer formal caps on MF interest rates but there are informal pressures from local government officials to keep rates down. The local borrowers never complain about 'high' rates, but local officials do.

Aside from the interest rate, government programs deduct 'fees and charges' for loans up front. In the end, even low rate loans end up actually costing the borrower about the same as high rate loans. 'Low rate' loans from VBARD compete with those available from INGO and NGO MF programs.

Staff working for MF programs that are a part of larger social welfare organizations like the Women's Union also have to do social mobilization. That is, they need the cooperation of local people to be considered successful, which makes it hard for them to put pressure on people to repay loans.

Donors fund numerous very small MF projects which compete and are never sustainable. Instead they should focus their resources on a few larger institutions which don't overlap and compete at the grassroots level.

4.3 Good practices of MF in Vietnam

Rather than identify outstanding institutions in the field, the participants presented a checklist for good practices in MF as follows:

- √ Strong organization with clear organizational structure and policies.
- √ Transparent management information and accounting systems which easily show the current financial health of the program.
- √ Form solidarity groups and train them in credit discipline right from beginning; if people don't repay on time, then the system breaks down.
- √ High repayment rates and compliance with discipline.
- √ Poverty targeting- choose the right people, who are the poor and the poorest.
- √ Aim for sustainability right from the beginning. A good MF organization must be able to calculate when its program will break even.
- √ Continuous internal control.
- √ Strong management team with adequately paid, full time staff. Policies and operational mechanisms must be clear at the beginning of program implementation.

4.4 Why do some borrowers default?

- Emergency cases and/or natural disasters (bird flu, flooding) since a great percentage of the loans are used for income generation through livestock rearing and small business development.
- Inadequate group guarantee or solidarity: For example, some groups do not meet frequently and appropriately or some group members do not support one another, or in some cases, people get loans in other members' names.

- Weak supervision from management board: In some cases some board members misuse the loan fund for personal purposes or do not update records properly.
- Inadequate program design: Some programs were designed in ways that were not appropriate for the poor; for example the required amount of compulsory savings was too high for the poor.

4.5 What changes are required?

- Improve the existing MF professionalism for stronger voice in advocacy and better collaboration among MF professionals.
- Train a cadre of professionals who can design, evaluate and staff larger MFI institutions; the State Bank is reluctant to grant licenses to numerous and small MF institutions.
- Create loan funds at the commune and district levels independent of the local government's routine regular budget.
- More MF institutions should be internationally recognized like CEP, which is rated by Planet Rating, a French qualified to rate professional MF institutions around the world.
- More attention to internal control apart from the accounting system.
- The MF Working Group should function as a research, training or/and resource center.
- It will be ideal if the Vietnam Bank for Social Policies could be reconstituted as a MF trust fund/bank of the Government.
- Banks should organize their pro-poor lending without subsidies to reduce the pressure on other MF institutions and to foster sustainability of the MF field.

5 People Interviewed

Ms. Nguyen Thi Bich Van, Program Coordinator, International Labor Organization (ILO)

Ms. Nguyen Hong Hanh , Finance Manager, Save Children US

Mr. Dang Xuan Kha, Micro Finance Team Leader, Save Children US

Mr. Dan Zook, Program Adviser, Plan International

Mr. Tran Van Long, Program Coordinator, Center for Rural Progress (CRP)

Ms. Nguyen Phuoc Nghi Dung, Program Officer, AusAID/Australian Consulate to Ho Chi Minh City.

Ms. Duong Ngoc Linh, Program Coordinator, TYM /Central Women Union.

Mr. Lukas Wellen, Senior Program Adviser, SNV

Mr. Bui Trong Nghia, Program Officer, Asian Development Bank

Mr. Adam McCarty, Chief Economist, Mekong Economics

Ms. Nguyen Vinh Ha, Economist, Mekong Economics

Ms. Tran Huynh Trang, Economist, Mekong Economics

Ms. Che Phong Lan, National Program Coordinator, World Vision

Mr. Vu Manh Hong, Expert & Consultant, the State Bank of Vietnam

Mr. Ta Van Tuan, Senior Program Officer, Action Aid Vietnam

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