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World Bank

**Vietnam: Developing a Comprehensive Strategy to Expand
Access [for the Poor] to Microfinance Services.**

Promoting Outreach, Efficiency and Sustainability

Volume I: The Microfinance Landscape in Vietnam

DFC S.A.

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List of Abbreviations

ACB – Asia Commercial Bank
 ADB - Asian Development Bank
 AFTA – ASEAN Free Trade Area
 APEC - Asia Pacific Economic Cooperation
 ASEAN - Association of South East Asian Nations
 ASEM - Asia-Europe Meeting
 BDS – Business Development Services
 BIDV - Vietnam Bank for Investment & Development
 BOP – Bottom of the Pyramid
 BRI – Bank Rakyat Indonesia
 CAS - Country Assistance Strategy
 CCF - Central People's Credit Fund
 CGAP- Consultative Group to Assist the Poor
 CIDA - Canadian International Development Agency
 Communes
 CPI - Consumer Price Index
 CPRGS - Comprehensive Poverty Reduction and Growth Strategy
 CPV - Communist Party of Vietnam
 CRS - Credit reference system
 DAF - Development Assistance Fund
 Danida - Danish International Development Agency
 Decree 28 - Prime Minister's Decree No. 28/2005/ND-CP on the Organization and Operation of Microfinance Institutions in Viet Nam
 DFID - Department of International Development
 EAB -Eastern Asia Commercial Bank
 EC - European Commission
 EU European Union
 FDI - Foreign Direct Investment
 FOE - Foreign Owned Enterprises
 GDP – Gross Domestic Product
 GoVN - Government of Vietnam
 GSO - General Statistics Office, Government of Viet Nam
 GTZ -Deutsche Gesellschaft für Technische Zusammenarbeit GmbH
 HEPR - Hunger Eradication and Poverty Reduction
 HIPC - Heavily Indebted Poor Country
 IAS - International Accounting Standard
 IDA - International Development Association
 IFAD - International Fund for Agricultural Development
 IFC - International Finance Corporation
 IFRS - International financial reporting standards
 ILO - International Labour Organisation
 IMF - International Monetary Fund

INGO - International Non-Governmental Organization
IP - International Partner
I-PRSP Interim Poverty Reduction Strategy Paper
JBIC - Japan Bank for International Cooperation
JSCB - Joint Stock Commercial Bank
JVEs - Joint Venture Enterprises
KfW - Kreditanstalt für Wiederaufbau
LIH - Low-Income Households
LPC - Local People's Committee
LUC - Land Use Certificate
MDG - Millennium Development Goal
MFI - Microfinance Institution
MFP – Microfinance Provider
MFWG – Microfinance Working Group
MLF - Microfinance Loan Fund
MO - Mass Organisations (Women's Union, Labourers Union, etc)
MoF - Ministry of Finance
MOLISA - Ministry of Labour, Invalids and Social Affairs
MPI - Ministry of Planning & Investment
MSME – Micro, Small and Medium Enterprise
NA - National Assembly
NBF - Non-Bank Financial Institution
NFHE - Non-farm Households Enterprises
NGO - Nongovernmental organization
NPL - Non-Performing Loan
ODA - Official Development Assistance
OECD - Organisation for Economic Cooperation and Development
PCF - People's Credit Fund
PRGF - Poverty Reduction and Growth Facility
Programme 135 - Programme for Socio-Economic Development in the Specially Difficult
PRSC - Poverty Reduction Support Credit
PRSP - Poverty Reduction Strategy Paper
ROSCA - Rotating Savings and Credit Association
Sacombank - Saigon Commercial Bank
SBV - State Bank of Viet Nam
SCUS - Save the Children Fund, United States
SIDA - Sweden International Development Agency
SME - Small and Medium-scale Enterprise
SOCB - State-owned Commercial Bank
SOEs - State-owned Enterprises
TA - Technical Assistance
ToR – Terms of Reference
TYM - Tai Yu Mai Fund
UNDP - United Nations Development Programme
USBTA - US-Vietnam Bilateral Trade Agreement
VBARD - Viet Nam Bank for Agriculture and Rural Development

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VBCP - Vietnam-Belgian Credit Project
VBD - Vietnam Development Bank
VBSP - Vietnam Bank for Social Policies
VFU - Viet Nam Farmer's Union
VLSS - Vietnam Living Standards Survey
VND - Vietnam Dong
VNPT - Vietnam Post and Telecommunication Corporation
VWU - Viet Nam Women's Union
WB - World Bank
WTO – World Trade Organization
WVA - War Veteran Association

Vietnam: Developing a Comprehensive Strategy to Expand Access [for the Poor] to Microfinance Services.

1. *Executive Summary*

The overall political and economic environment for microfinance in Vietnam is stable and improving. The economic dynamism and the overall financial reform program in Viet Nam provide a solid foundation for the integration of microfinance into the overall financial system, enabling the financial system to serve the majority of the population inclusively. However, microfinance as a sustainable financial service business approach targeting the poorest segment of society is not well established in Vietnam. There is no strategy for microfinance as such and the industry is not well integrated in the financial sector, reflecting a somewhat immature market. There is still a widespread tendency for some in the Government to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be supported by subsidies. This creates a number of policy distortions that combined with a legal and regulatory framework in transition and institutional weakness, requires attention and a number of decisions by the government.

Between 70 to 80 % of the poor in Vietnam are reached and have access to microfinance services, at least credit and savings, which are provided primarily by the formal institutions: the Viet Nam Bank for Agriculture and Rural Development (VBARD), the Vietnam Bank for Social Policies (VBSP) and the People's Credit Fund (PCFs). However, the quality of the services and the range of products provided (outreach) is not satisfactory yet. The demand among the poor and low-income households of Viet Nam today is for well-designed, affordable and customer-responsive financial products delivered flexibly and conveniently. Most micro-customers will prefer to use one provider for all their financial needs, but the extensive multiple borrowing evident in Vietnam indicates that few providers are fulfilling this broader demand, and customers are left to compose a suitable financial services package from the multiple available sources and product ranges. The rapid expansion of credit offered by the formal financial system reaches deep into the low income and poor segment of the population, but reports from International non-governmental organization (INGO) programs in the field also indicate an increasingly segmented market and sophisticated demand by the poor for larger and differently structured loans as well as for a broader range of services, including micro-insurance and leasing finance and remittances.

The very poor households and micro-entrepreneurs in more remote areas are not as well served, neither in terms of outreach nor of quality of outreach, and there is a need for more flexible and demand-driven services. The semi-formal microfinance providers (MFPs) should attempt to extend their outreach to the very poor in the most remote and rural communities furthest from formal bank outlets. Despite the higher costs, MFPs should try to achieve better market penetration in communities of ethnic minorities, who are clearly the segment of the population most adversely affected by poverty, and least served. To focus on this market segment and at the same time increase sustainability,

however, will require MFPs¹ to achieve a higher level of innovation, efficiency and adaptation than exists today. It may also require higher interest rates than those charged in other more easily reachable areas to compensate for the higher transaction costs.

In the middle market segment of the poor, microfinance institutions (MFIs) under Decree 28 will need to compete for market share against VBSP and in a market also covered by the formal institutions in the upper range of the market and by the Mass Organizations in the lower segment. Even innovative MFIs may find it hard to keep costs within the squeezed financial margins of the Vietnamese market in general, but no MFI with the double bottom line objective of serving the poor sustainably can compete *on price* with the government-subsidized VBSP, thus the need to review the policy on interest rates.

To carve out a share in the well-served Vietnamese market for financial services to the low income and poor population, any MFP or new entrant considering registration under the Decree 28 would have to deliver very demand-responsive, innovative and diverse services in a customer-friendly, flexible and extremely efficient manner, and would have to have the capital available to grow the portfolio to scale quickly in order to attain sustainability. They will also have to strengthen their internal management and operational systems so that they are able efficiently to handle larger and more diversified portfolios. And finally, they will need to improve their financial management, recording and reporting (transparency) to be able to demonstrate a level of financial performance that could attract the capital necessary to enable the required portfolio growth while efforts should be stepped up to 'graduate' resourceful clients to the formal providers which could serve their broader demand better, leaving the limited capital of the semi-formal MFPs to be available for the poorest segment. It must be noted that few MFPs (or even MFIs) fully meet these requirements at present.

In the much more competitive and diversified market segment of the low-income households and microfinance enterprises (MSEs), which accounts for the overwhelming majority of the micro credits and the savings mobilized, the larger, more established and better capitalized main players are VBARD, the PCFs and VBSP. The Joint Stock Commercial Banks (JSCBs) are slowly expanding into provincial capitals in more rural areas, but their coverage is still limited and generally linked to financial operations with firms headquartered in the large urban areas and will largely remain outside rural areas in the present interest rate environment. VBARD, the PCFs and VBSP require better market information, appraisal tools and systems to meet the growing and diversifying demand more responsively, particularly if they are to increasingly expand their markets into the lower segments of the low income population and the poor. Targeted external credit made available for intermediation will not necessarily support the internal development process needed to reach the low income and the poor market segment and make it profitable. Thus, if competition has to be increasingly based on market terms and not only on quality (thus providing additional stimulus for the involvement of JSCBs),

¹ The term Microfinance Provider (MFP) is applied in the report to institutions providing microfinance services operating outside the "formal" financial system, while the term Microfinance Institution (MFI) is applied to those operating within the formal financial system. MFPs may also be referred to as "semi-formal MFIs."

VBSP's subsidized credit mechanism must be gradually eliminated while continuing to emphasize quality, and the key quality concern of the poor is permanent access (thus sustainability) to appropriate products (thus innovation).

The future microfinance market in Vietnam, one fully integrated with the financial sector, will have no room for providers with diluted focus, scattered outreach, and limited skill. The present day semi-formal MFPs that will succeed under Decree 28 will be those characterized by business-orientation, good market research and open to customer-feedback so that providers can strengthen, adapt, adjust and innovate their products and delivery systems to respond to the changing market demand and the increasing demands by the low income and the poor for quality, consistency and responsiveness. With the added competition as interest rates are liberalized, only the most professional and efficient operations that are able also to serve the under-served remote areas of the country are likely to succeed in the longer term. Few of the semi-formal MFPs presently operating in Vietnam in the currently immature industry are likely to successfully convert into Decree 28 institutions, and those that become successful MFIs will do so through a process of closures, consolidations and mergers among MFPs.

The key to successful financial service provision to low income and poor people, both by formal as well as by present-day semi-formal MFIs that may transform under Decree 28 will also lie in the ability of providers to develop their risk management, controls skills and systems of delivery so they can cost-effectively reach a critical mass of clients and generate a profit to the institution. This means maintaining good portfolio quality (Portfolio at Risk (PAR)² of less than 5%), and attaining financial self-sufficiency (being able to cover all direct and indirect costs of operations by income earned from the operations). A sustainable scale (break-even point) in Vietnam for microfinance providers lending at the current SOCB rates of around 12 % per annum is roughly estimated to be 3000-5000 customers or a loan portfolio of around US\$ 1.5 million for institutions that mostly mobilize their own resources (for instance, PCFs) at their current efficiency levels, and at least US\$ 500,000 for MFPs that lend from resources mobilized externally (grants, onlent funds). The semi-formal MFPs are free to set their own interest rates; most charge the current SOCB rate, but some do charge higher interest rates. Nevertheless, outside of the formal (regulated) financial system, very few MFPs (9 of the 44 MFPs reporting to the Microfinance Working Group) in Vietnam have attained such a scale because their limited financial resources and their concentration on a limited geographic area.

Developing a credit reference system will help improve coordination and information sharing on customers and avoid (or reduce) the high but unreported level of multiple borrowing in Vietnam and the risk of portfolio failure. Developing mechanisms for the MFPs and MFIs to rate/score their own customers and making the information available would also help reduce the risk of portfolio failure. The already existing linkages in the microfinance market through the widely applied Framework Agreements between VBARD, VBSP and the Mass Organizations need to be strengthened so that the

² Portfolio at Risk (PaR) is generally used in microfinance rather than the banks' equivalent Non-performing Loans (NPL) in keeping with the practice at CGAP.

“graduation” of bank-ready clients from informal and semi-formal to formal microfinance institutions can be expanded.

The market for business support services to microfinance in Viet Nam needs to be strengthened. There are few specialized providers, and potential providers in the rapidly expanding private sector have not established linkages to the clients (market) of microfinance providers. This is due in part to the isolation of the nascent, development-oriented microfinance industry from the general business community, which is typically seen in industries dominated by governments, social organizations and to some extent INGO-funders and donors that bring in-house expertise to their programs and do not necessarily explore options for service provision in the national market place. It is illustrative that one of the lead INGOs in microfinance, Save the Children Fund, US (SCUS) with the support of the International Labor Organization (ILO), are considering the establishment of an “NGO training center” rather than perhaps contracting training services from existing resources within the private business service sector.

The direct lobbying of the State Bank of Vietnam (SBV) has clearly increased the visibility and legitimacy of the Microfinance Working Group (MFWG), the informal microfinance network of practitioners. However, the coordination and communication between MFWG and the formal MFIs and banks as well as with the donor agencies needs to be improved if they want to increase their ability to influence more enabling legislation and more timely regulations. Moreover, the MFWG seems to have missed – or avoided – the opportunity to work closely with the key microfinance stakeholder ‘by default’, the Women’s Union. The Women’s Union participates in the MFWG, but there is a need to further cement a solid lobbying alliance of the technically stronger INGOs in the MFWG core group, who could advocate and formulate good microfinance practices, and the politically well-connected and respected Mass Organization, which could promote the key concerns and suggestions from ‘inside’ the highest level of government. Improving these potentially strong alliances would benefit both the microfinance industry and the SBV in producing and obtaining government approval of good-practice based Circulars under Decree 28.

The government needs to reenergize the overall policy debate on microfinance as a self-sufficient financial business segment with social underpinnings rather than a poverty lending instrument and the dialogue intensified with the institutions in the sector, the donors and the Mass Organizations who currently manage the vast majority of semi-formal microfinance. The issues over policies as manifested in the subsidized market mechanisms of VBSP and the development of an enabling legislative framework under Decree 28 need to be addressed and framed in the context of a coherent microfinance strategy.

This new dialogue should help develop an overall consensus among all stakeholders on the adoption of a coherent strategy for a microfinance sector adhering to performance-based, results-oriented good practices in an inclusive financial sector. It is hoped that this report will contribute to this dialogue, enhancing the access to finance by all in the unique Vietnamese microfinance market

2. *Background and Introduction*

Vietnam has made considerable progress in reducing poverty in the last decade, but there are still about 4.6 million households (slightly more than 24% of the population) living in poverty³, and it remains one of the poorer countries in the world. The financial sector in Vietnam has been growing rapidly and with it the coverage of low income and poor people (“outreach”) by microfinance institutions. And improved access to a range of appropriate, affordable and demand-driven financial services by the poor and low-income people has been demonstrated globally and in Vietnam to be one of the factors which underpin the ability, particularly of the low-income people, to extricate themselves from poverty by increasing their incomes in a sustainable way⁴.

The evidence that microfinance services can influence positively the reduction of poverty is mostly operational, as there are few impact studies to support this conclusion from ground information. The operational evidence comes from the cumulative findings that low-income and rural poor demand financial services and that they can pay for them and as a result, banks and other commercial sources for financial services are now downscaling to this market segment. It also comes from the increasing financial support by donors to Microfinance Institutions (MFIs) and to the Government through donor project funds to support the sector directly, as well as to improve and enhance the enabling environment for the microfinance sector through legal and regulatory reforms in the financial and microfinance sectors.

Box 1: Key Principles of Microfinance developed by CGAP:

1. Poor people need a variety of financial services, not just loans.
2. Microfinance is a powerful tool to fight poverty.
3. Microfinance means building financial systems that serve the poor.
4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.
5. Microfinance is about building permanent local financial institutions
6. Microcredit is not always the answer
7. Interest rate ceilings hurt poor people by making it harder for them to get credit.
8. The job of government is to enable financial services, not to provide them directly
9. Donor funds should complement private capital, not compete with it
10. The key bottleneck is the shortage of strong institutions and managers
11. Microfinance works best when it measures—and discloses—its performance.

Poor people often lack the capacity necessary to become economically independent and they cannot fully access societal resources to help in attaining this goal. Poor people are often under-educated, inexperienced in business, in poor health, saddled with large families they can barely care for, isolated in rural villages or urban slums, or often discriminated against, as

³ Using the national income poverty line that was modified by Prime Minister’s decision 170/2005/QĐ-TTg, the overall poverty rate in 2004 has declined from 23% in 2002 to 18.1% of the population or some 14.8 million people in 3.4 million households. If the international poverty line of US\$ 1/day (VND 480,000/month) is applied, the percentage of poor people increases to around 24% of the population or 21 million people in 4.6 million households.

⁴ Several articles on the matter can be found on: www.yearofmicrocredit.org, www.cgap.org, www.microfinancegateway.org, www.microfinance.org, etc

in the case of Vietnam, because of ethnicity. Poor people also often lack access to the capital necessary to drive existing or potential businesses, for want either of personal assets or collateral, or of financing from friends, family or acquaintances willing to invest. As such, financial services from banks or other formal financial institutions typically elude poor people. And in the minds of the government and some of the donors there was the need to ascertain what the situation is in Vietnam in terms of the ability of the poor to access microfinance services.

Moreover, the microfinance industry in Vietnam still displays some characteristics, namely fragmentation, lack of regulation and a degree of inefficiency that raise questions about outreach and its sustainability, about its path of future development and its integration within the financial sector of Vietnam. Despite the best intentions of the government and despite the support of international donors and of the stakeholders themselves, Vietnam has not had a coherent and comprehensive strategy for the microfinance sector and until recently not even contemplated its eventual integration into the financial sector. The absence of a coherent strategy framework for microfinance, which takes into account the particularities of Vietnam, as well as the internationally accepted microfinance best practices, is fiscally costly, distorts the financial market for microfinance and results in inefficiencies in the allocation of resources. It may therefore reduce the positive effect that the sector should have on poverty alleviation

With this background in mind, the World Bank contracted as well as supervised the work of a consulting team from a consortium, headed by DFC, Spain, which carried out the work to develop a **Comprehensive Strategy for Enhanced Access to Microfinance in Vietnam**. The strategy should target the 24% of the low income and poor households in Vietnam and help adopt enabling policies that increase outreach, efficiency and sustainability by strengthening microfinance institutions to provide more diversified and higher quality financial services particularly to the targeted population. The strategy should also propose policy, legal and regulatory environment improvements that would help integrate the microfinance industry into the overall financial system and develop a sounder and deeper financial market, itself a key factor in economic growth.

This report is produced in response to the request from the World Bank. Its purpose is twofold: to present a landscape of the microfinance industry in Vietnam and to provide the government an outline of the elements of a sustainable microfinance strategy in the country which include a number of options for interventions to increase outreach, efficiency and the sustainability of the sector that are consistent with the country's relevant policies and strategies as well as internationally accepted best practices. The report is based on the key findings of the consulting team. During the almost three weeks field work in Vietnam, the Team used a participatory, open interviewing data collection approach, as it progressed through a well thought out methodology. It consulted with more than 30 different organizations, including Microfinance Providers (MFPs), Apex organizations, Government Ministries and Agencies, and key donors. The Team also undertook desk research, read several documents, conducted interviews and carried out a survey with the intention of gaining a better understanding of Vietnam and global best practice.

The report, “*Vietnam: Developing a Comprehensive Strategy to Expand Access [for the Poor] to Microfinance Services. Promoting Outreach, Efficiency and Sustainability*” is divided in two Volumes: Volume I, “The Microfinance Landscape in Vietnam” which assesses the microfinance landscape in Vietnam and Volume II, “Options for a Comprehensive Strategy” II which based on the data and analysis of the first volume, presents a series of strategic options for transforming institutions, regulations, and policies in the sector which in the short to medium term could help alleviate the existing constraints for enhanced access to microfinance. The two volumes together provide a framework for a comprehensive strategy for enhanced outreach and higher efficiency and sustainability in the microfinance sector, based on international best practices which in the medium to long term would integrate sustainable microfinance providers (MFPs) into the financial system of Vietnam and facilitate their future development as an integral part of the financial sector.

Volume I includes a qualitative and quantitative analysis of the microfinance providers in the economy. It reviews Vietnam’s financial market structure in general, with the specifics of the microfinance sector. It identifies who are the poor in Vietnam, the natural customers of microfinance, presents the market for microfinance services in terms of the nature and size of demand and supply and in the process identifies the main institutional players in the industry. It also analyses the performance of the key institutions and their sources of financing and describes the structures and activities that support the industry, including technical assistance and development partners. This volume also includes a general overview of the legal and regulatory environment relevant to the microfinance industry.

Volume I is structured in 7 chapters. **Chapter 3** presents the approach and methodology followed by the team for the study. **Chapter 4** presents the setting for microfinance in Vietnam. It briefly describes the growth and macroeconomic performance of the country, as well as the policy dialogue and the reform agenda of the country. It also analyses the effect of growth on poverty and presents the financial, legal and regulatory environment in Vietnam and the relationship to microfinance. **Chapter 5** reviews and analyses the microfinance market in Vietnam; it identifies the customers of microfinance, and analyses the market in terms of demand and supply for microfinance services. It also reviews the performance of the microfinance institutions. **Chapter 6** reviews the support services in the microfinance sector: technical assistance, advocacy and coordination and the development partnerships. Finally, **Chapter 7** presents the key findings in terms of existing constraints and issues that need to be addressed in the process of developing an appropriate strategy for microfinance in Vietnam.

The views and recommendations expressed in this report are those of the DFC/MKE Team, and do not necessarily represent the views of the World Bank, SBV, nor other Vietnamese microfinance stakeholders.

3. Approach and Methodology

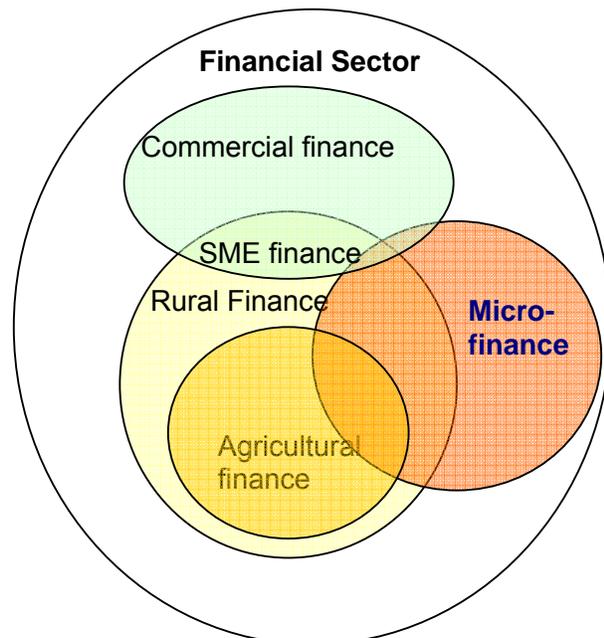
A) Overall approach

In response to the TOR, the analysis of the environment and the microfinance sector review utilized a financial systems development approach, involving an assessment of the size and characteristics of the overall client market; of the existing microfinance retailers; of the business support infrastructure for these retailers (e.g. training, TA, audit, IT provision); and of the enabling environment at macro-level, including policies, legislation and regulation pertaining to or affecting the microfinance sector, especially the Microfinance Decree.

Figure 3.1: The Financial Systems Development Approach



Within the financial sector of Vietnam, commercial finance (corporate, private, personal and large enterprise finance) dominates, and is offered by the State-owned Commercial Banks, Foreign banks, Joint Venture banks and urban Joint-Stock banks, which also to some extent offer financial services to Small and Medium sized Enterprises (SMEs) – the market segment currently most intensively supported by donor agencies as the engine for growth in Vietnam. SME finance covers financial services to enterprises employing 10-300 staff with total assets not exceeding VND 10 billion (USD 640,000).



B) Delineation of Microfinance

In this report, we focus on the provision of financial services (savings, credit, insurance, remittances etc.) to poor and low-income households and their businesses, often known as micro-enterprises, which in Vietnam are defined as enterprises with a monthly revenue of VND 6-40 million (USD 375-3.750) and employing less than 10 staff. The majority of micro-enterprises (MEs) is run by the entrepreneur him- or herself helped by the household members.

Micro-credit became popular in the 1980's as a system of credit delivery using effective collateral substitutes to deliver and recover short-term working capital loans to poor micro-entrepreneurs based on the examples of Grameen Bank in Bangladesh and others. Contrary to general beliefs, the poor (especially women) have demonstrated better repayment habits than most conventional bank customers.

Realizing that poor people also use and need financial services beyond working capital, such as savings, insurance, and money transfers, the global industry adopted the term microfinance in the 1990s to more accurately describe the intervention, while maintaining a target group of the poor who are often excluded from access to the conventional banking system. Contrary to the widespread belief that microfinance needed subsidies, we learned from the poor that consistent and convenient access to increasing credit and other financial services is more important than the price. The laws of microfinance are embedded in good operating practices and re-enforced by social contracts. Many microfinance institutions (MFIs) emerged and, adjusting their pricing, began to emphasize sustainability through cost-coverage to decrease their dependency on external funding. As NGOs or other semi-formal providers, they remained largely outside the purview of prudential financial regulations, however, and intermediating savings, began to pose a risk to the safety of poor people's deposits.

By around 2003, the provision of financial services to the poor thus changed name again - Inclusive Finance now summarizes the two aspects of inclusion sought by the industry: the access not just by micro-entrepreneurs, but by all poor and low-income earners – “the Bottom of the Pyramid” (BOP) – to appropriate financial services; and the integration of microfinance into the formal financial sector. Today, inclusive finance remains focused on providing appropriate, market-responsive and demand-driven financial services to the poorest segment of a given population in a sustainable manner, but recognizes that the funds needed to secure this access by far outweighs any donor and government budgets. In order to access the private capital markets, microfinance has to professionalize and demonstrate that financial services to the poor can be provided as professionally, safely and profitably as conventional banking. Institutions with large infrastructures, such as commercial banks and financial cooperatives can play a significant role in scaling up financial services to the Bottom of the Pyramid. Only if financial services to BOP are integrated into the overall financial systems of

developing countries, can large-scale sustainable service delivery hope to be achieved. Inclusive finance describes the present-day sector-wide development strategies that focus on:

- Opening the financial services markets to increasingly poor and geographically remote customers;
- Integrating the providers of sustainable microfinance into the formal financial sector to allow more access to capital and better protection of poor people's savings; and
- Increasing the legitimacy and professionalization of the microfinance industry, without compromising its social mission⁵.

The vision of an Inclusive Financial system is client centered. It is based on the assumption that financial services play a critical role in reducing poverty by enabling poor people to accumulate and manage assets, conduct financial transactions, manage cash flows, invest in their businesses, and reduce their vulnerability to external shocks. The two long-term goals of microfinance are thus *substantial outreach* and *sustainability*. When knowledge of or attention to these good practices is insufficient, the short-term losses and the longer-term unsustainable impact of such operations ultimately harm the very clients that they were meant to benefit.

⁵ See CGAP Donor Brief no. 11, March 2003. <http://www.cgap.org>

4. The Setting for Microfinance in Vietnam

A) Country Profile of Vietnam

The total population of Viet Nam is 84.9 million (2006 estimate) growing at 1.44% per year⁶, of which 63% or 53.5 million people are in the economically active age range⁷, with the majority of the population (approximately 76%) living in rural areas. Since the program of economic renovation “Doi Moi” (national renewal) was initiated by the Communist Party on its Sixth Congress in 1986 and affirmed by the 1992 and 2001 Constitutions, Vietnam has transformed from an isolationist communist society to an open and internationally integrated economy governed by socialist principles with an increasing orientation towards a market economy. With impressive success, the governmental regulation of the economy was reduced and the market was opened to foreign investments. Recent economic growth, has been remarkable. In 2001-05 it averaged over 7.5% p.a., reaching a peak of 8.4% last year. This year the growth rate is expected to reach 8%.

Vietnam is one of the fastest growing economies in the world and this trend is expected to continue in 2006⁸ and in the foreseeable future. This buoyant performance combined with the commitment of the Vietnamese government to economic liberalization and international integration, and the gradually intensifying reforms to modernize the economy and to produce more competitive, export-driven industries, has led, inter alia, to Vietnam’s accession to the WTO on November 7, 2006 and its ratification by the National Assembly on November 28.

A key factor in this remarkable growth has been the rapid modernization of the agrarian economy. Industry and construction accounts for 40% of the GDP, service for 38.1% and the agricultural sector (agriculture, fisheries and forestry) contributes 22% of GDP (2004)⁹. It is important to highlight, that even though agricultural production is still rising, industry’s still-higher growth rate means that agriculture’s share of economic output continues to shrink, from about 25% in 2000 to 21% last year and by the year 2010 it may be down to 15%.

Vietnam is considered to have prudent and appropriate macroeconomic policies that have generated macroeconomic stability (including sustainable levels of external debt) and an environment conducive for growth, while prudent fiscal policy has resulted in small budget deficits, a relatively small stock of debt and a sustainable share of public spending in GDP. However, Vietnam has followed a different strategy from other transition economies; massive divestiture of state assets is not a central component, and the pace of structural reform in the state owned sector has been an issue between GoV and the international financial institutions.

⁶ FAO: Demographics of Viet Nam, July 2005.

⁷ IMF: PRSP February 2006

⁸ The Gross Domestic Product (GDP) grew by 8.4 % in 2005, the highest level in nine years. In the first quarter of 2006, GDP is estimated to have risen by 7.2 % year-on-year

⁹ World Bank: Viet Nam at a Glance, September 2005.

While the share of the state-owned sector has remained relatively constant since 2000, at 38-39% of the GDP, the 'individual and private economy' is increasing, and the state now owns less than 3% of assets in agriculture. Job creation in the private sector has been massive as economic liberalization has unleashed unprecedented entrepreneurial activity at all levels. Private enterprises now account for some 33% of the value of production in manufacturing, and in 2005 alone, some 40,000 private enterprises applied for a business license, representing an increase of 9 % in number and 43 % in registered capital over the previous year. The average capital of these new enterprises at about 170 thousand dollars, though small, has doubled in the last five years. Over the last decade, the average wage has grown at around 7% per year in real terms. The enormous opportunities created through this process have led to an inclusive growth pattern, with the Gini co-efficient, which measures economic inequalities, remaining relatively low and stable at 0.37¹⁰. Indicators of domestic consumption and investment are robust. Overall, the ratio of investment to GDP reached 38% in 2005, and Viet Nam successfully issued its first international bond in October, 2005.

The achievements of Vietnam in poverty reduction have been striking, and the country is poised to attain the Millennium Development Goals by 2015 if progress continues

at the rate achieved over the past years. The implementation of the MDGs in Viet Nam is reflected in the GoVN socio-economic development goals and plans which govern the policies for

mobilization of domestic and international development resources with priority given to less developed regions, poorer and more vulnerable groups. With reference to the global MDGs, Viet Nam has established its own 12 development goals (referred to as Viet Nam's Development Goals or VDGs), which include social and poverty reduction targets for 2010.

In Viet Nam in general, access to education, health and participation by the population in the labor force is considerably higher than in countries at a similar level of development, and targeted poverty programs have facilitated the access to these benefits also by the poor through subsidies. Massive urban job creation has allowed the absorption of some 1.55 million entrants to the labor market in 2004 and offered a way out of farming for many rural poor. While this has increased the pace of urbanization in the main city centers of Ho Chi Minh City, Da Nang and Ha Noi, urban unemployment has remained stable at around 6%. In rural areas, the continued investments and restructuring within and around the dominant agricultural sector increased employment time to 79.1% from 77.66% in 2003¹¹, reducing unemployment to 1.1%¹².

The Goals

Box 2: Millennium Development Goals:

- Goal 1: Eradicate extreme poverty and hunger
- Goal 2: Achieve universal primary education
- Goal 3: Promote gender equality and empower women
- Goal 4: Reduce child mortality
- Goal 5: Improve Maternal Health
- Goal 6: Combat HIV/AIDS, malaria and other diseases
- Goal 7: Ensure environmental sustainability
- Goal 8: Develop a global partnership for development

¹⁰ UNDP: the MGDs and the SEDP, November 2005.

¹¹ State Bank of Viet Nam: Annual Report 2004. World Bank: Doing Business reports that 60% of the total workforce in Ha Noi in 2004 is wage earners. However, in the mixed Vietnamese economy, also wage earners can be poor.

¹² IMF: PRSP February 2006.

The rapid economic growth in the country, which is led by the private sector, has resulted in significant increases in domestic consumption (the retail sales index, an indicator of household expenditure, rose by 20.5% during 2005, and by 19.6% year-on-year in the first five months of 2006) and in impressive annual poverty reduction rates of up to 3.5 percentage points¹³. The average per capita income in 2004 was about VND 8.6 million/person/year (US\$ 543), up by 14.67% from 2003¹⁴ and is around US\$638 equivalent at present. Between 2002 and 2004 households have witnessed a large (21%) and relatively equitable rise in real per capita income across income quintiles, but especially significant in the middle three income groups¹⁵.

	Income quintile					Total
	Poorest	Near-poorest	Middle	Near-richest	Richest	
Real income per capita per year ('000 dong)						
2002	1414	2322	3212	4667	10790	4480
2004	1696	2826	4025	5850	12725	5424
Real income growth 2002-2004 (percent)	20	22	25	25	18	21
Contribution to total income 2004 (percent)						
Agriculture	55.5	46.1	37.3	28.5	14.7	26.9
Wage	25.6	27.9	29.3	32.1	32.6	31.1
Non-farm self-employment	7.7	13.1	19.3	22.4	26.0	21.8
Other	11.1	12.9	14.1	17.0	26.7	20.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Contribution to total income growth 2002-2004 (percent)						
Agriculture	27.2	35.0	21.5	21.9	8.1	17.9
Wage	49.2	34.5	30.8	26.3	28.0	30.0
Non-farm self-employment	8.3	11.9	26.9	26.4	4.7	15.0
Other	15.3	18.6	20.7	25.4	59.3	37.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Note: Income source categories reflect main occupation only.

Table 4.1 Sources of income growth by income quintile (2002-2004)

The growth of the economy has been accompanied by remarkable poverty reduction, with the poverty headcount falling from 58% in 1993, to 37% in 1998; 29% in 2002; and as low as 24% by 2004, meaning that a third of the population has been lifted out of poverty during this period, mainly due to job creation in a market-oriented private sector, policy reforms in the agriculture sector, increased availability of credit and remittances (it was recently reported that since 1988, US\$23 billion has flowed into Vietnam, making up about 60% of all FDI). The Vietnam Living Standard Survey (VLSS 1992–93, 1997–98 and 2002) and Poverty Survey (1999) show that reductions in poverty were different between rural and urban areas, economic regions, ethnic groups, education and gender. Poverty was reduced in a much slower pace in the central region, the poorest in the country and the Northern mountain and north central coast, while the proportion of ethnic minorities in the overall poor population increased. It is estimated that 85% of the poor live in rural areas. The Asian Development Bank (ADB) reckons that deep poverty in Vietnam—defined as a daily income equivalent to under \$1—is now only slightly more prevalent than the average for South-East Asia, whereas in 1990 Vietnam's figure was more than twice the regional average. By this measure, Vietnam has overtaken China, India and the Philippines and now has only slightly more poverty than Indonesia.

¹³ World Bank: Taking Stock – an Update on Vietnam's Economic Developments and Reforms, Mid-Year CG meeting, June 2006.

¹⁴ State Bank of Vietnam: Annual report 2004.

¹⁵ Phung Duc Tung (2006) quoted in World Bank: Taking Stock, 2006, from where Table 5.1 is also taken.

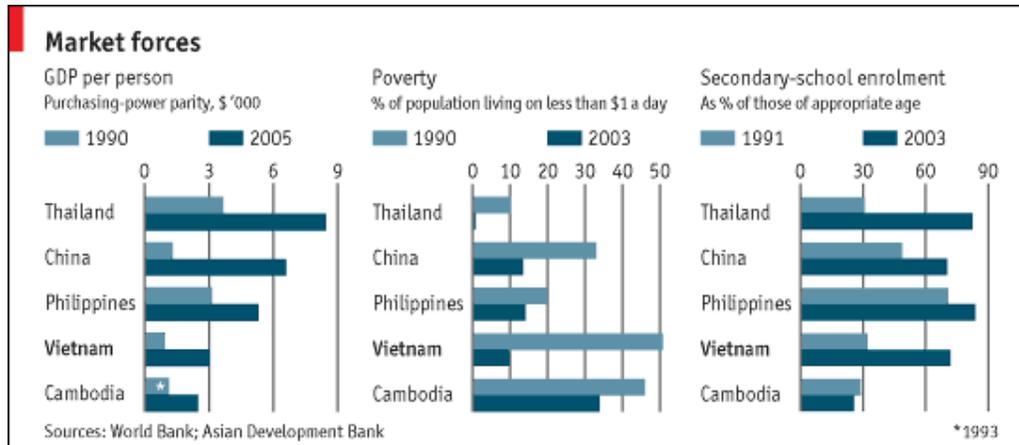


Table 4.2 Comparative Data from GDP, Poverty, and secondary enrolment

Regarding exports, Vietnam has been growing faster than China, since 1990, and this growth shows no signs of slackening. In addition, Vietnam's exports grew in 2005 by almost 22.4% in value terms, followed by 24.2% year-on-year in the first 5 months of 2006 amounting to \$22 billion, helped by a recovery in the garments sector. This trend is expected to continue growing at a rate of 15% in the next years. Goods and services exports now constitute about 67% of GDP¹⁶. Crude oil accounted for 22% of total export revenues in 2005; other major export items include textiles, garments and footwear, seafood, timber products, rice, coffee, cashew, pepper and coal. It has just become the world's largest exporter of pepper and aims soon to overtake Thailand in rice. Vietnam's largest markets are the United States, the EU, Japan, China and Australia. Garments and footwear, after being flat in the first half of 2005, recovered in the second half to record an annual growth of 14.4% and 21 % respectively. Their strength has continued in the first five months of 2006. However, an antidumping suit being imposed on leather footwear from Vietnam could dampen exports to the EU.

Vietnam has also pursued a strategy of integration with the world economy, joining the Association of Southeast Asian Nations (ASEAN) in 1995, AFTA in 1996, the Asia-Europe Meeting (ASEM) in 1996, and the Asia Pacific Economic Cooperation (APEC) in 1998. The entry into force of the US-Vietnam Bilateral Trade Agreement (USBTA) in December 2001 was a major step towards the accession to the World Trade Organization (WTO), which was achieved in December 2006. The rapid export growth has been aided by these bilateral and regional trade agreements that have come into effect since 1996, most notably the ASEAN Free Trade Area (AFTA) and the US Bilateral Trade Agreement.

One of the most striking features of Viet Nam's rapid growth is the rise of the industrial sector, which grew by 8% in terms of share of GDP between 1997 and 2003. Industry represented 40% of GDP in 2004, yet it is important to note that growth in output in the sector has not been accompanied by a commensurate rise in employment. Agriculture, despite its recent decline, remains the top employer of the Vietnamese labor force.

¹⁶ Taking Stock, an Update on Vietnam's Economic Developments and Reforms. World Bank Vietnam, Mid-Year Consultative Group Meeting for Vietnam, Nha Trang, June 9 – 10, 2006

Rapid economic growth has also resulted in increasing imports and large balance of trade deficits. In 2005, Vietnam's imports grew by 15,7%, but the trade deficit narrowed to 1.6% of GDP in 2005 compared with 5% in 2004. As exports far outpaced imports in the first quarter of 2006, the trade balance swung to a surplus of 8% of GDP. With overseas remittances (official formal inflows) estimated to have ranged from US\$3.5 to 4 billion, the current account deficit is estimated to have narrowed to 0.3% of GDP in 2005 from 3 % in 2004¹⁷. Vietnam's major imports are refined petroleum products, urea, steel ingots, pharmaceuticals, machinery and spare parts, textile and garment inputs, plastics and chemicals. Imports are mainly from ASEAN, China, Taiwan, Japan and the EU. Strong import growth will be needed to meet Vietnam's 2005 targets for industry, construction and agriculture.

Retail sales growth was around 18.5% in 2004. Inflation, as measured by the Consumer Price Index (CPI), averaged 8.2% for 2005. Some of the factors responsible for this were: avian influenza (which forced a cull of 20% of poultry stocks), a 30% wage increase for state employees, a significant increase in world prices for steel, refined petroleum products, fertilizer and cement and droughts and floods in parts of Vietnam.

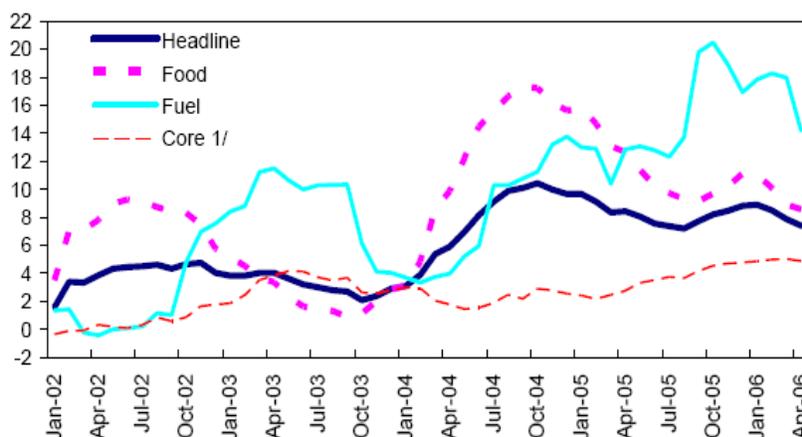


Table 4.1 Consumer Prices, 2002-06, Inflation (period average, percentage change, year-on-year)¹⁸

Actual foreign invested capital in 2004 was around US\$2.9 billion, with industry and construction accounting for nearly 70 % of this total. Services, in particular hotel, tourism, and office and apartment building services, accounted for around 25 %. As part of its effort to maintain the momentum in foreign direct investment, Vietnam has undertaken a privatization program for its state-owned enterprises (SOEs). However, while the Government plans to reduce the number of SOEs to around 2,000 by 2005, it failed to meet the target set for 2003 and met only 68 % of its 2004 schedule.

Vietnam will continue to attract substantial Official Development Assistance (ODA), composed of grants and soft loans from bilateral and multilateral creditors. Net foreign lending to

¹⁷ Seventy per cent of remittances come from the United States, followed by Australia, Canada and Germany. The Government of Vietnam estimates that there are 2.7 million Vietnamese residing overseas of which 1.2 million are in the United States.

¹⁸ International Monetary Fund, Vietnam: Selected Issues, November 2006, IMF Country Report No. 06/422

Vietnam, about 80% of which is ODA-based, will increase from \$1.4 billion in 2004 to about \$2 billion by 2006¹⁹. The growth of net foreign lending will help boost Vietnam's foreign exchange reserves by about \$1 billion in 2005 to around \$7.5 billion. Remittances are expected to keep climbing in 2006, attracted by growing investment opportunities in equities, real estate and family businesses.

Net foreign direct investment inflows will continue to increase in 2006. Total approved foreign direct investment (FDI) in 2006 is estimated to have been US\$ 10.2 billion, a year-on-year increase of about 47%. The largest investors were Singapore, Taiwan, Japan, ROK, and Hong Kong. In addition to Vietnam's WTO accession and related liberalization of foreign investment rules, the strong growth of private consumption is attracting foreign investors. These investors are increasingly targeting the services sector in order to capitalize on Vietnam's consumption boom.

Vietnam's unemployment declined in 2005 and this trend is supposed to continue in 2006 as private consumption and investment in the private and services sector is growing rapidly²⁰. By October 1, 2006, the government will increase minimum wage by 28.6 %²¹, this being the third time that Vietnam has raised the minimum salary since 2003. The continued growth of employment, real wages and foreign remittances will support strong private consumption growth in 2006 and beyond.

Prudent fiscal management has resulted in general macroeconomic stability, a key ingredient for a favorable investment climate. The government has maintained a budget deficit of between 0.1 % and 2.8 % over the period 1997-2003, and government debt that is attributable to budgetary expenditures including ODA on-lending stood at 33% of GDP at end 2003. Even if recent bond issues to finance infrastructure and education projects are factored in, as well as recapitalization costs of state-owned commercial banks, the total debt figure to GDP would remain a manageable 36%. Its important to highlight, that Vietnam is not heavily aid-dependent.

B) *The National Policy Dialogue and Reform Agenda*

Although Vietnam is a low-income developing country, it has had a very good record on poverty reduction and macroeconomic stability since the Sixth Party Congress initiated a program of economic renovation ("Doi Moi") in 1986. This economic reform package introduced market reforms and dramatically improved Vietnam's business climate. It initially aimed at shifting economic priority from heavy industry to three major economic programs

¹⁹ ODA accounted for an annual average of 4.5% of GNI from 1994–2003 (OECD/DAC 2004); as a percentage of government expenditure it comprised 18% in 2000 and 12% in 2001. In 2003, 25 bilateral international donors, 19 multilateral international donors and 500 NGOs of all types were operating in Vietnam¹⁹. Japan (JBIC), the World Bank and the Asian Development Bank (ADB) are the three largest donors; other donors among the top ten donors in 2003 were France, Australia, Denmark, the EC, the Netherlands, Germany and the UK. The top ten donors represented around 88% of total ODA disbursements with around 580 projects or 52% of all projects reported in 2003 (United Nations Development Programme – UNDP – 2004).

²⁰ Vietnam's unemployment rate has steadily declined from 6.4% in 2000 to 5.6% in 2004. The decline in the unemployment rate is partially explained by the limited nature of state-owned enterprise restructuring.

²¹ Under a newly-issued government decree, the monthly minimum salary of people working in the administrative sector, armed forces, political and social organizations, and state-owned enterprises will stand at 450,000 Vietnamese dong (VND) (28.3 dollars), instead of 350,000 VND (22 dollars) currently.

namely: production of food, production of consumer goods and production of exports; reducing state intervention in business; and encouraging foreign and domestic private investment, to a socialist oriented multi-sectoral economy operating under the market mechanism and state management, and called for more structural reforms.

The impact of the socio-economic reform process in Vietnam in the last decade has been impressive, both in terms of economic growth and poverty reduction. However, there remains a dichotomy between introduction of a dynamic, open economic management system and a political system that changes only slowly and reluctantly; and between socialist ethics and the market economy. The role of state planning in a transition economy like Vietnam has been a recurrent theme since the late 80s. As the involvement of the state in production is gradually reduced, the government's economic plans should focus on qualitative rather than quantitative objectives. Modern planning aims to organize and regulate the inputs for production, rather than set output targets. The small size of the Vietnamese economy facilitates the design, control and evaluation of economic policies. The new five-year plan, approved at April's congress of the ruling Communist Party, is laden with targets for increasing output and improving infrastructure, with the objective of making Vietnam a modern, industrial nation by 2020.

Informational asymmetries, externalities and other market imperfections provide a rationale for government intervention in the economy. The state can initiate new markets, ensure the availability of credit, provide access and investment in education and health. The new approach to planning is starting to focus on a reappraisal of the rationale for government involvement in each area of public intervention, in particular, on the regulatory framework and anti-trust legislation and the incorporation of private elements in public service provision. It also is more concerned with the budget allocation of resources, in providing qualitative rather than quantitative targets for government intervention and in stimulating new areas of comparative advantage. Examples relevant to Viet Nam are the development of mortgage and insurance markets, the provision of credit to small and medium sized enterprises (SMEs) and in rural areas, the promotion of technological research.

WTO accession, a high priority for the government, was achieved in November 2006. Particular attention will need to be devoted to the consequences of competition with WTO members. In the agricultural sector, the competition from the subsidized producers in the US and the EU will have limited adverse effects because Viet Nam is already a food exporter.

Poverty reduction has been one of the declared targets in Vietnam that have had a large degree of consensus. As a result, Vietnam has managed to reduce poverty quickly while achieving a high level of economic growth. This growth created jobs and provided better livelihoods. In the poverty debate, there has been a growing awareness of the need to combine growth with equity, and tensions between the adoption of targeted approaches vis-à-vis broader policy solutions to address equity in light of the areas of increasing socio-economic differentiation and new forms of vulnerability that have inevitably resulted from the reform process.

Even though Vietnam is a non-HIPC country it prepared its own Comprehensive Poverty Reduction and Growth Strategy (CPRGS). The GoV chose to undertake this process in order to qualify for access to PRSC and PRGF funding. The CPRGS considered microfinance as an important part of its strategy of poverty reduction, recommending expanding the successful models of sustainable micro-finance and creating a favorable and stable environment for credit and micro finance operations as well as the rural finance system. Measures include reduction of capital and credit subsidies and expansion of sustainable microfinance models initiated by NGOs or other civil organizations. However, the CPRGS also stipulates that the Government will continue in the immediate future to provide subsidized credit to poor households. CPRGS also pledges to subsidize financial institutions operating in disadvantaged areas to help them to cover high transaction costs and maintain a general parity of interest rates.

The Comprehensive Poverty Reduction and Growth Strategy states the following:

Chapter 3 Creating an Environment for rapid, sustainable development and poverty reduction:

- The need to create close linkages between groups of depositors and borrowers in the banking system; expand successful models of sustainable micro-finance initiated by NGOs or other civil organizations; tightly link the provision of credit for cultivation with agricultural extension.
- The need to create a favorable and stable environment for credit and micro finance operations to increase the flexibility of the rural finance system work in order to meet the needs of the poor. Reform and renovate the rural credit and finance systems, diversify credit instruments to attract private investment in the manufacturing and processing of agricultural products.

Chapter V regarding major policies and measures to develop sectors and industries to promote sustainable growth and poverty reduction states the need to "Improve access to financial and credit services in rural areas (saving and credit); reform and renovate the rural financial and credit system, establish a sustainable credit market, create conditions to facilitate investment in modernizing and diversifying agricultural products and to mobilize private investment in processing high quality products. Expand the savings fund system and develop policies to mobilize dormant capital from communities to generate more credit resources for the rural sector. Strengthen the role and improve the organization and the general direction of the VBP and PCFs. Improve loan procedures and formalities by introducing the one-stop shop approach. Pay special attention to providing medium and long-term loans and match them to the production cycle. Apply appropriate credit policies to targeted groups; create conditions for poor and disadvantaged people, with priority given to women, to access credit at reasonable interest rates and on a timely basis. In the near future, continue to apply the policy of providing credit at low interest rates to poor people; in the long term, policy will shift from subsidizing interest rates towards improving access of poor people, especially women, to credit by simplifying lending procedures combined with providing training. Directly subsidize banks and credit funds that operate in disadvantaged areas to offset their additional transaction costs, thus enabling them to maintain interest rates on a par with the general level.

Concentrate resources on successfully implementing the National Targeted Programs for Hunger Eradication, Poverty Reduction, and Employment during 2001-2005 Continue to allocate resources and create opportunities for poor households to reduce poverty in a sustainable way: expand credit to poor households so that they can develop business production.

There is now wide consensus that policy reform actions will improve transparency and accountability in SOE operations and in the banking sector as well as in public finances, in the latter by addressing a number of gaps in the Budget Law and that the establishment of a sound regulatory framework will result in increased private investment and exports leading to additional job creation. Policy reforms in the social sectors will promote human development through improved access by poor people to education and health care, and more secure asset ownership in the form of a new land law. Overall these reforms will lay the foundations for a state ruled by law.

Through appropriate measures and proactive programs, the Government has by and large been able to mitigate the potential adverse economic, social and environmental impacts of increased trade openness, reduction in state enterprises, and liberalization in land transactions. However, incomplete structural reform could jeopardize growth and stability in the longer term. And haphazard introduction of market forces in the social sectors, and the

trend towards decentralization may put service delivery under strain. Moreover, fast integration with the world economy may lead to increased instability by exposing Vietnam to market forces as they prevailed before the Asian crisis of 1997-98. It may also lead to increased inequality, at least temporarily, as the benefits accrue to specific regions and skills disproportionately. Growth in Viet Nam could become less equitable in the years to come. The Government needs to continue its efforts to revamp its anticorruption strategy and to improve fiduciary controls and fiscal transparency. Thus, the Government must continue its program of effective policy reform, including the removal of the remaining structural weaknesses, promote socially inclusive development, and modernize governance and public administration

C) *The Financial System and the Banking Sector*

The financial sector in Vietnam is progressively deepening in response to overall economic transformation and increased demand from the private sector for credit. The restructuring of the state-owned banking sector, the emergence of private banks, and the commitments made by the Government to open the economy to foreign banks are beginning to orientate the sector to more market driven approaches that respond to customer needs. However, Viet Nam's financial sector remains largely undeveloped, with many local business transactions occurring outside the banking system. And the banking sector remains weak from a global perspective, although there has been some progress in the sector's restructuring efforts. The mono-bank system in 1980's represented by the SBV was gradually replaced by a two-tier banking system. This situation led to the definition of new roles and responsibilities for second-tier banks and to the creation of independent banking institutions, not a trivial achievement. The banking system that has emerged is dominated by state-owned commercial banks (SOCBs), in part as a legacy of the past. Lending continues to be oriented towards giving priority to state-owned enterprises (SOEs) and is largely collateralized by land or property (as opposed to microcredit). A start has been made on developing the leasing sector, but the industry is still new and small.

The SOCBs account for more than 70 % of all bank deposits and hold approximately 75% of outstanding bank credit. More than 26 foreign bank branches and 34 semiprivate joint stock banks (JSBs) have operations on a limited local scale, serving niche markets, together supplying around 17% of the commercial credit market. The non-state sector, which includes private companies, households and individuals is clearly the core market for the 36 Joint Stock Commercial Banks (JSCBs) in Vietnam. Lending to the private sector accounted for 73% of the total JSCB loan outstanding (2003) and was provided as consumer loans (35%) and commercial loans to SMEs. For many of the JSCBs, the average loan size per customer exceeds VND 600 million, indicating that they do not in general serve the low income and poor. The operations of the dominant SOCBs in Vietnam have been characterized by weak balance sheets, in part reflecting a legacy of directed lending. In Vietnam the four large SOCBs have maintained a high exposure to state-owned enterprises (SOEs). The lack of reforms in the state-sector has led to a buildup of nonperforming loans (NPLs), although some more recent information suggests that the problems with NPL is not restricted to SOEs. Generally weak lending practices and excessive exposure to the SOE sector had thus become one key

source of vulnerability in the countries' financial system. One of the key elements of the strategy to promote greater transparency in Vietnam has been to move loan classification closer to international standards and subjecting SOCBs to IAS audits. This was done through Decrees 493 on IAS audits and 457 on prudential regulations (both in 2005).

The reform efforts initiated in 2001 were centered on restructuring the four large SOCBs and putting them on a commercial footing. The strategy was framed by the authorities' decision to retain full ownership and control of the banks and not to rely on any outside agents of change, such as strategic foreign investors. Beyond restructuring the SOCBs, banking sector reforms also aimed at strengthening the regulatory, supervisory, and institutional frameworks for more efficient banking. In addition, the authorities have also pursued consolidation of numerous small and undercapitalized JSBs.

Under a donor-funded reform program, the four largest SOCBs have undertaken important changes to improve information management systems, loan approval procedures, credit risk control and the recovery process of delinquent loans. However, the administrative costs in the SOCBs are still relatively high, and their asset quality low; current Non-Performing Loans is estimated to be over 15%²². Their inadequate governance structures remain vulnerable to pressures to lend through political influence in management, especially at the local levels²³. Notwithstanding that a change in lending behavior is expected to take time, an initial assessment suggests that Vietnamese SOCBs continue to give priority to asset growth over profitability and capital adequacy. In spite of their continued dominance of the banking sector, SOCBs allowed interest rate margins to erode substantially until about 2003 when they began to raise lending rates while offering higher deposit rates to finance rapid credit growth. As a result, profitability has begun to turn around allowing for some capital growth. However, capital asset ratios (measured using domestic accounting standards) are still low and there is still the need to clean up balance sheets and restore adequate capital cost as part of SOCB restructuring.

Efforts to strengthen banking supervision are still at an early stage. In Vietnam, the allocation of supervisory responsibilities among the various departments involved at the SBV, the lead agency in banking supervision, is complex and may need simplification. Enforcement mechanisms where banks violate prudential and other regulations need to be tightened. In addition, supervision by the central bank may be affected by the SBV's ownership function at the SOCBs, which appears to undermine credibility of enforcement as well.

The reforms initiated in 2001, are also reflected in the rapidly rising level of formal financial intermediation in the country. Confidence in the banking system has grown rapidly as evidenced by the rapid growth in deposits from 43 % of GDP in 2000 to 56 % in 2005. In addition, credit to the private economy has grown rapidly, climbing by 42% year-over-year in 2004, but slowing to around 32% in December 2005, and 25% in February 2006. This has been accompanied by a significant increase in the availability of credit and other financial

²² This figure, however, would be closer to 16% if international accounting standards (including rescheduled loans in Portfolio at Risk) were fully put in practice Viet Nam Development Report 2006: Business.

²³ Viet Nam Development Report 2005: Governance. Joint Donor Report to the Consultative Meeting, Ha Noi, 1-2 December 2004.

services to the segment of the population considered as poor, primarily in the rural areas. However, by some estimates, only about 32 % of the poor had debt from any kind of financial institution (formal, semi-informal or informal) by 2003.

In 2003, the SBV adopted a new reform strategy (which is now being revised and expanded to reflect the Government's socioeconomic development plan (SEDP) 2006–2010 for the entire banking sector and the development of the capital markets. In addition, a comprehensive roadmap for banking sector reform was issued through Prime Minister's Decision 112 of May 24, 2006. A key step is to fundamentally re-write the Law on Credit Institutions and the Law on the SBV. However, the issue of expanding access to finance for the poor, the related role of policy lending institutions in the economy, and the channels of financing support for the poor, such as the mix of welfare, training, subsidized credit, and other state-sponsored programs on the one hand and market-based services on the other, has received much less attention in the new reform strategy. In the area of global financial integration, potential strains could follow the opening of financial markets to foreign financial institutions. Adherence to international standards should be accompanied by a regulatory effort to put foreign and domestic banks on a level competitive ground.

It will be crucial to sustain the supply of credit and to guarantee access to credit across sectors and geographical areas. The banking sector in Viet Nam is still dominated by state-owned banks, which provide almost all the credit received by state-owned enterprises (SOEs). The growth of the private sector will gradually reduce the importance of SOEs in the economy and many of the latter are also being privatized. Therefore, as the share of credit to state-owned companies is reduced, the provision of subsidized credit will also be reduced which will gradually remove the burden of directed financing from the banking sector.

Nevertheless, Vietnam's expanding economy enables a reasonable growth potential for the banking sector, given that a significant proportion of financial assets are held outside the banking sector, thus providing opportunities for financial intermediaries. The sector also benefits from government support for the system, as demonstrated by a capital infusion of Vietnamese dong (VND) 10.4 trillion (US\$624 million) into the five state-owned banks over the last two- to three-year period.

D) The Legal and Regulatory Framework for Inclusive (Access to) Finance

Access to financial services or outreach of the financial system has become a major concern for many policymakers in developing countries, and in Vietnam this has been a serious concern for the Prime Minister's Office (PMO) and the SBV, who have sought international aid in developing and restructuring the Vietnamese financial sector. Since the initiation of economic reform, apart from the amendment to the constitution recognizing a multi-sector economic system and a new Civil Code which recognizes individual ownership, the National Assembly has passed many other laws and ordinances governing the functioning of a market economy.

In the financial sector, Vietnam has been going through an intense reform that will continue in the upcoming years as can be seen from Decision 112-2006-QĐ-TTg of the Government dated 24 May related to the Scheme on Development of Vietnam's Banking Sector up to 2010 and Orientations toward 2020. This roadmap introduces some measures for development of the Vietnamese banking industry in the next five-year period. This is a promising and ambitious roadmap for banking reform that will definitely have an impact on access to finance. Nonetheless, despite the efforts of the Government, progress in the banking sector has been slow. The general consensus is that liberalization has been moving positively, but slowly.

The depth of the finance sector in Vietnam is impressive, and poor people can access some financial services and have benefited from the liberalization of the interest rate and directed credit from VBARD and VBSP. Currently in Vietnam, poor people use financial services, to obtain assets (cars, motorbikes, television, etc), make home improvements, addressing life cycle needs such as education or marriage; seasonal events such as those relating to harvest, school fees, or festivals; and emergencies such as illness, theft or natural disasters.

Microfinance institutions and banks in Vietnam have reached about 4 million people, a considerable proportion of the poor population. However, it is crucial to gain a better understanding of the demands and needs of microfinance clients in order to expand and improve access to financial services and this will require a deeper involvement of the private sector and the capital it can mobilize. Nevertheless, the microfinance industry is evolving rapidly with micro lenders "transforming" into regulated banks and microfinance entities traditionally supported by donor contributions beginning to explore how financial resources can be mobilized in capital markets, but this might take some time.

a) *Banking Legislation and Regulations*

Since the introduction of its "*doi moi*" and in order to promote domestic and foreign investment, Vietnam has gradually developed its banking and finance regulatory framework. Despite a number of reforms in response to the entry into WTO, Vietnam's banking and finance sector remains tightly controlled. In Vietnam, the responsibility for regulation of the financial services sector is delegated to various Government bodies. The SBV regulates the banking and finance industry, and is responsible for monetary policy. The MoF is responsible for fiscal policy and also regulates the insurance sector. The State Securities Commission ("SSC") regulates the securities sector - the SSC was originally established as a stand-alone entity, but it was transferred into the MoF under *Decree 66-2004-ND-CP of the Government dated 19 February 2004*.

As Vietnam integrates deeper into the global economy, the need for regulating the banking sector and restructuring State owned commercial banks has become a stated high priority for the Government. The number of reforms in the past 12 months indicates that the momentum for change is growing. Currently banking institutions in Vietnam are governed by the Law on Credit Institutions dated 12 December 1997 as amended by the Law on Amendment of and Addition to the Law on Credit Institutions dated 15 June 2004 (effective as of 1 October 2004).

Recently, on May 2006, the GoV, approved Decision 112-2006-QD-TTg of the Government dated 24 May related to the Scheme on Development of Vietnam's Banking Sector up to 2010 and Orientations toward 2020. Of note, planned reforms include:

- In 2008, the NA will consider and pass a new Law on the SBV, Law on Credit Institutions and Law on Deposit Insurance (currently deposit insurance is regulated at decree level only). A Law on Supervision of Safety of Banking Activities is also planned.
- Forex regulations will be relaxed in order to liberalize further current transactions and capital transactions.
- Regulations on market access for foreign investors will be reformed to fulfill Vietnam's commitments to the US, the EU and others to open the banking and finance market (no indication of timing).

Vietnam is currently not a party to the 1998 Basel Capital Accord. The SBV has never indicated any official intention to adopt principles of Basel II the new framework to update the capital adequacy rules of Basel I. Regulations on minimum capital prudential ratios in the operations of credit institutions fall under Decision 457-2005-QD-NHNN of the State Bank of Vietnam dated 19 April 2005.

b) NBF I Legislation and Regulations including leasing and insurance

Non-banking financial services in Vietnam are governed by the Law on Credit Institutions dated 12 December 1997 as amended by the Law on Amendment of and Addition to the Law on Credit Institutions dated 15 June 2004 (effective as of 1 October 2004). Under article 20.3 of the Law on Credit Institutions (As Amended), a non-banking credit institution is described as *“a credit institution permitted to engage in some banking activities as its regular business, but not permitted to receive demand deposits and to provide payment services. Non-bank credit institutions consist of finance companies, finance leasing companies and other non-bank credit institutions”*.

Implementing the Law on Credit Institutions, Decree 79-2002-ND-CP of the Government dated 4 October 2002 on Organization and Operation of Finance Companies provides for the establishment and operation of finance companies in Vietnam and Decree 16-2001-ND-CP of the Government dated 2 May 2001 on Organization and Operation of Finance Leasing Companies (as amended by Decree 65-2005-ND-CP of the Government dated 19 May 2005) provides for the establishment and operation of finance leasing companies in Vietnam. To implement Decree 79 on finance companies and Decree 16 on finance leasing companies, the SBV issued Regulations on Opening and Termination of Operation of Branches and Representative Offices of Non-Banking Credit Institutions under Decision 24-QD-NHNN dated 7 January 2003. Decision 24 only applies to branches and offices located in Vietnam operated by NBCIs established in Vietnam.

Decree 79 provides for the establishment and operation of finance companies in Vietnam, including joint venture and 100% foreign owned finance companies, with no distinction between the scope of activities of foreign invested and domestic finance companies. “Finance company” is defined as a NBF I which uses its own capital or raises capital to conduct lending and

investment and provides financial and monetary consultancy services, but which is not permitted to provide payment services or to receive deposits for a term of less than a year. Foreign exchange activities and debt factoring may be permitted with SBV approval. Finance companies are licensed by the SBV for 50 year duration (extendable for successive 50 year durations). *Decree 79* also regulates commencement of operations (mandatory within 12 months of licensing), establishment of branches and subsidiaries, raising capital and credit activities. Finance companies are subject to mandatory requirements with respect to risk reserves, prudential limits, reporting and inspection, as currently applicable to other credit institutions. *Circular 06-2002-TT-NHNN of the State Bank of Vietnam dated 23 December 2002* provides guidelines on a range of matters relating to the organization and operation of finance companies

Decree 16 (as amended by Decree 65) provides for the establishment and operation of finance leasing companies in Vietnam, including joint venture and 100% foreign owned finance leasing companies. "Finance leasing" is defined as medium or long term credit operations carried out on the basis of a finance leasing contract entered into between the lessor (being the credit institution) and the lessee. Finance leasing companies are permitted to undertake finance leasing transactions in foreign currency according to the *Official Letter 18-NHNN-CSTT dated 7 January 2003*.

Regulations on Organization and Operation of the Board of Management, Inspection Committee and (General) Directors of Non-Banking Finance Institutions were issued under Decision 516-2003-QD-NHNN of the State Bank of Vietnam dated 26 May 2003. This regulations apply to:

- a) NBFIs belonging to credit institutions and finance companies belonging to State corporations, where those NBFIs have their own boards of management and boards of control (collectively referred to as dependent NBFIs); and
- b) Joint venture NBFIs and 100% foreign owned NBFIs (collectively referred to as NBFIs involving foreign elements). Decision 516 does not apply to joint-stock NBFIs or to subsidiaries of NBFIs which do not have their own boards of management and boards of control.

Regarding Insurance, Vietnam's insurance industry is regulated by the *Law on Insurance Business dated 9 December 2000* (effective 1 April 2001), implementing *Decree 42-2001-ND-CP of the Government dated 1 August 2001* and *Circular 98-2004-TT-BTC of the Ministry of Finance dated 19 October 2004*, and *Decree 43-2001-ND-CP of the Government dated 1 August 2001* and *Circular 99-2004-TTBTC of the Ministry of Finance dated 19 October 2004* on financial regime applicable to insurers and insurance brokers.

Under the *Insurance Law*, types of insurers comprise State owned, shareholding, mutual and foreign invested. To be licensed by the MoF, all insurance businesses (domestic and foreign invested) must:

- 1) have paid-up charter capital no less than the level of legal capital stipulated by law (ie at least USD10 million);
- 2) have qualified and experienced management personnel; and

- 3) provide operational plan for first 5 years, specifying economic benefits of establishing the new business.

The range of insurance products which may be provided is strictly regulated by Circular 98 of January 2005. The financial regime applicable to insurance businesses is regulated by *Decree 43-2001-ND-CP of the Government dated 1 August 2001* and *Circular 99-2004-TT-BTC of the Ministry of Finance dated 19 October 2004*. *Circular 99* introduced various reforms consistent with international market practice, including in relation to establishment of insurance reserves and to disclosure of information by insurance businesses to the public and purchasers of insurance.

c) *Legislation and Regulations on Cooperatives*

Under the centrally planned economic system, emphasis was laid on creating very large co-operative units, as these were believed the motor of progress, development, and greater socialization. After Doi Moi, former agricultural co-operatives had to be completely restructured in their organization and business activities in order to survive in a liberalized market economy. After the collapse of the rural credit cooperatives in the early 1990s it was quickly realized, however, that the larger SOCB could not fill the void in rural finance. Therefore, in 1993, the GoV decided to set up a revised rural savings and credit cooperative system by the Decision of The Governor of the SBV on the regulation on organization and operation of people's credit Fund. Article 1 of this law states: "*People's Credit Funds (hereinafter referred to as credit funds) are credit organizations in the form of cooperative whose members are individuals, legal entities. They deal with credit, monetary activities and banking services in order to help members to promote production, trade and living standard on the basis of mutual help and mutual interest.*"

One of the most important objectives had been the need to restore public confidence in the formal rural finance system. Therefore, the term "cooperative" had been deliberately excluded from the name of this newly-established finance institution and they were called People's Credit Funds (PCF).

These credit unions are commune level savings and credit cooperatives, inspired by the Desjardins (Canada) model. The mobilization of local savings and the provision of credit services are its main functions. The long-run objective of the PCFs is for the whole system to become economically viable and to compete with commercial banks. The CCF, the apex organisation, has been established in August 1995. While all units are legally independent and do their accounting separately, they are interlinked with each other.

Like the cooperative movement in general savings and credit cooperatives are guided by three major principles, i.e. self-help, self-administration and self-responsibility. Self-help means that people join forces, raise the necessary financial means for the joint cooperative undertaking themselves and are prepared to give mutual help. Self-administration means that the members organize the internal conditions of their cooperative society themselves ("internal democracy"). Hence, the cooperative is not subject to third party's orders. Self-responsibility means that

members themselves are responsible for the foundation and upkeep of the cooperative enterprise with respect to business partners in order to establish confidence in economic life. These principles are reflected in the Vietnamese Law on Cooperatives, effective 1 January 1997. This Law defines the cooperative as: “*cooperative shall mean self-control economic entity established by working persons who have common needs and interests, and contribute voluntarily capital or labour in accordance with the provisions of the law to promote strength of collective and each member for the purpose of mutual assisting in ever more effective carrying out manufacturing, business, service activities and in improving living standard, contributing to socio-economic development of the country.*”

Basically, PCFs comprise individuals which voluntarily join a social group (“cooperative society”). At the same time the cooperative represents a business unit which has to be registered to participate in economic life. In addition, there is a two-fold connection between a member and the cooperative. On the one side, a member is a shareholder and therefore co-owner of the cooperative enterprise. On the other side, a member is a client of the cooperative to take advantage of its offers.

While rules and regulations of all types of cooperatives are outlined in the national cooperative laws and specified in the bylaws of each individual one, savings and credit cooperatives are, in addition, always under the supervision of the SBV. In general, these cooperatives are classified as financial institutions or banks, particularly if they pursue non-member business. Hence, savings and credit cooperatives not only fall under the stipulation of the Cooperative Law, but also under the jurisdiction of the Banking Law.

In general, PCFs seem to have a certain advantage over commercial banks in the competition for clients when it comes to credit. Although credit risk appraisals conducted by savings and credit cooperatives should not differ from the procedures employed by other banks, the personal integrity of the credit applicants and the economic viability of the proposed investment are seen as more important factors than the provision of collateral. Banks mainly look at the value of collateral first when deciding on credit. This reinforces the status quo of the actual asset ownership and income distribution, and may even increase the unequal distribution pattern.

d) MO and NGO Legislation, Policies and Regulations

The term “non-governmental organization” was officially used for the first time in the Law on Organization of the Government (1992) and now is used in a number of regulations, but there is no official definition yet of what an NGO is. Vietnam does, however, have organizations that are similar to what other countries call NGOs, especially in the field of humanitarianism and charity. In fact, the 1992 constitution of Vietnam stipulates in Article 69 that “*Citizens have the right to freedom of speech, freedom of press, the right to communication, meetings, demonstration, to form associations in accordance with the law of the country.*”

In addition, Vietnam, being a socialist civil law country has two legally recognized forms of non-profit organizations (“NPOs”) according to the Civil Code. The first form can be found in Art. 110.1.d). “*Social organisations and socio-professional organisations*”, which are in essence

associations. Also Art 114 of the Civil Code establishes: *“Social and socio professional organizations may be established and their charters approved, by the competent state authority. The assets of such organizations may consist of voluntary contributions and fees from members and other individuals or organizations. The purposes of such organizations are to meet the common needs and objectives of their members. Such organizations shall have the status of legal persons in civil relations.”*

Associations are not *required* to be established for public benefit, though they are generally so established (e.g. an association of doctors providing medical services in an impoverished community). Although the Civil Code does not clearly address the issue, Decree 88 states that associations can be established for the purpose of contributing to the country’s socio-economic development. (Article 2). Associations that engage in activities pursuant to such purposes may be linked to the Government’s tasks and supported by the State Budget according to the Prime Minister’s instructions. (Article 4.2). Because of the elaborate process required to establish an association, it is likely that many will in fact carry out public benefit purposes that are tied to the State’s development objectives. In general, other associations described in the Civil Code and the regulations (e.g. clubs, professional associations) tend not to be established for public benefit. Thus, “Socio-professional” organizations are funded and closely linked to the state and political structures.

The second form of NPO can be found in Art. 110.1.e). as *“social and charity funds”* which are in essence foundations. This type of institution is developed in Art 115 of the Civil Code *“Social and charitable funds may be established and their charters approved by the competent state authority. Such funds shall operate for the purpose of encouraging nonprofitable cultural, scientific, charitable, and other social and humanitarian activities. Such funds shall have the status of legal persons in civil relations. Assets of the social and charitable funds shall be managed, used, and disposed of in accordance with the provisions of law and pursuant to the operational objectives of the funds as provided for in their charters. Social and charitable funds shall carry out only the activities provided for in their charters that have been approved by the competent state authority and only within the scope of the assets of their own funds and shall bear civil responsibility by utilizing those assets.”*

Even though they are identified under more complex names, these two forms are equivalent to the typical civil law forms of association and foundation. The Civil Code and two Government decrees are the major legislation governing NPOs in Vietnam. The Civil Code contains a number of provisions that govern the legal framework for NPOs. The two decrees, one from 1999 and one from 2003, spell out details about the structure and governance of NPOs.

Regarding Foreign NGOs and in order to create favorable conditions for their establishment in Vietnam and a legal framework, the Prime Minister issued on May 24th, 1996, Decision 339 /TTg on establishing the Committee for NGO Affairs²⁴ and Decision 340/TTg on issuing Regulations on the Operation of Foreign NGOs in Vietnam. This was the first legal

²⁴ The Committee for NGO Affairs was later dissolved according to Decision 79 /TTg dated 6th July 2000 of the Prime Minister and a Committee for Foreign NGO Affairs was established under Decision 59/2001/QD-TTg dated 24th April 2001.

framework to regulate the operation of foreign NGOs in Vietnam. As stipulated in the Regulations, foreign NGOs are entitled to conduct development assistance and humanitarian activities in Vietnam that are not-for-profit or other purposes and have to register for permission with the Government of Vietnam.

Foreign NGOs operating in Vietnam are required to abide by the scope and fields of activity stipulated in the issued Permits. The Chief Representative of Representative Offices, or the chief of Project Offices or the person(s) authorized to represent foreign NGOs' operation in Vietnam are accountable for all activities of the NGOs performed in Vietnam. The person(s) authorized by an NGO to be its representative(s) or chief of its project office is required, every three (3) months, and the chief of a representative office every six (6) months, to report in writing to the Committee on the operation of the NGO in Vietnam and to also report and provide documentation or explanation to the Committee on matters related to the operation of the NGO whenever requested. Other issues in relation to the operation of foreign NGOs in Vietnam that are not mentioned in the Regulations are subject to current laws and regulations of Vietnam. Thus, foreign NGOs, are subject to quite different regulations from those applying to local NGOs

Finally, Vietnam *Mass organizations* (which are party organizations) are established pursuant to their own legislation. They are deemed “part of the political system of the Socialist Republic of Vietnam” (Law of the Vietnam Fatherland Front of 1999), and, as such, are not taxed. Examples include the Vietnam Women’s Union and the Vietnam Farmers Association.

Vietnam has many mass organizations, such as the General Confederation of Labor, the Ho Chi Minh Communist Youth Union, the Women’s Union, the Peasants Union, and the War Veterans Association. All of these People Organizations are united in the Fatherland Front, a broad alliance and voluntary federation of sociopolitical organizations representing the various social classes and strata, ethnic groups, and religions. The Front and its affiliates constitute the political and social foundation for the peoples power, a venue whereby to unify actions of the various strata of the population in striving to realize democracy and implementing economic, cultural, and social development.

e) *Legislation and Regulations on Enterprises*

One of the most important aspects of economic reforms in Vietnam is the encouragement of domestic and foreign private investment. The Company Law, the Law on Private Businesses, the Law on Encouragement of Domestic Investment and especially, the Law on Businesses (which replaced the Company Law and the Law on Private Businesses and is considered most liberal) have had profound impacts on the development of the private sector in Vietnam.

The development of these laws has been gradual, and after many years of comprehensive renewal and integration into the world economy, Vietnam legislation on enterprises has several types of enterprise for investors to select. These types of enterprise include:

- State enterprise;
- Different forms of company (joint-stock company, one-member limited liability company, limited liability company with two or more members, partnership);

- Private enterprise;
- Foreign-invested enterprise (joint-venture enterprise; enterprises with 100% foreign-owned capital).

Apart from the above-named types of enterprise, there are assorted cooperatives which also constitute a type of enterprise in terms of their operation. At present, the classification of these types of enterprise to determine their respective applicable laws is based mainly on the criterion of enterprise ownership. For different types of enterprise, and up to June 2006, there were several laws, namely:

- The 2003 on State Enterprise Law, providing for State enterprises;
- The 1999 Enterprise Law, dealing with companies of various forms and private enterprises;
- The 2000 Law on Foreign Investment in Vietnam, prescribing foreign-invested enterprises;
- The 2003 Cooperative Law, dealing with cooperatives.

With the ownership criterion, these laws have established different legal statuses for different types of enterprise. The new Law on Enterprises (*Law 60-2005-QH 11 on Enterprise*), effective from 1 July 2006, is intended to apply equally to domestic and foreign invested enterprises. Before this reform, domestic companies were regulated under the 1999 Law on Enterprises, while corporate governance requirements for foreign-invested enterprises were set under the Law on Foreign Investment in Vietnam. The new *Law on Enterprises* will regulate the establishment forms and procedures, organization and management, and dissolution of enterprises in all economic sectors.

With the passage of the Enterprise Law, both domestic companies and foreign invested enterprises should in theory be subject to a uniform system of corporate governance. However, The Enterprise Law gives foreign-invested enterprises the choice of either re-registering and converting into the form of an enterprise governed under the Enterprise Law, or not re-registering and continuing to 'conduct business operations within the scope of the lines of business and period stated in its investment licence' and continuing to 'enjoy investment incentives in accordance with the regulations of the Government'. This peculiar operation of certain transitional provisions in the Investment Law and the Enterprise Law may mean that in practice Vietnam may still have a dual system of corporate governance after 1 July 2006. In any case, there is only a two-year window in which to make this decision.

Also, as of 1 July 2006, a single *Investment Law (Law 59-2005-QH 11 on Investment)*. will regulate both foreign and domestic investment. The *Law on Investment* will regulate investment guarantee measures, investment sectors and regions which are encouraged, investment procedures and investment incentives that will apply to domestic and foreign investors.

Under the new duo laws, foreign direct investors are permitted to establish enterprises in any form available under the *Law on Enterprises*, ie limited liability company, shareholding company, partnership or private enterprise (except where the law restricts the form of establishment in a particular sector). Such enterprises may exist in perpetuity (but the projects

they invest in remain of a limited duration as stipulated in their investment certificate). Currently, foreign invested enterprises (FIEs), comprising joint venture enterprises (JVEs) and 100% FOEs, are a 'special' form of enterprise peculiar to the *Law on Foreign Investment in Vietnam* where investors own "capital contribution" not shares, have a limited license duration, and are subject to separate 'company law' than applies to Vietnamese enterprises.

f) *The Policy Dialogue on Microfinance: Decree 28*

In March 2005, the government of Vietnam issued Decree 28 - 28/2005/ND-CP to regulate the organization and operation of microfinance institutions. This decree grants microfinance institutions (which are currently operating semi-formally) two years to convert into regulated microfinance institutions, raise the required capital and apply the new legislation to their operations. This decree is considered to be a positive step towards integrating the country's fragmented industry, strengthening its institutional capacity, facilitating its access to commercial funds, and encouraging the adoption of internationally recognized good practices. Nonetheless, this decree raises a number of concerns in a market where subsidized credit and de facto interest rate controls are pervasive, particularly in the microfinance industry. In addition, the institutional weakness of many of the semi-formal MFPs and limited capacity of SBV to implement the decree remain one of the biggest challenges that need to be addressed.

It is important to highlight the main aspects of the Decree 28, which can be summarized as follows:

- Only Vietnamese NGOs, social-political and social organizations, charity funds and social funds are eligible to apply for a license from the central bank;
- Applicants should have prior approval from the provincial or city-level People's Committees, the main government authorities;
- Minimum capital requirement for MFIs that cannot accept voluntary savings is 500 million VND (around \$32,000);
- Minimum capital requirement for MFIs that can accept voluntary savings is 5 billion VND (around \$320,000);
- MFIs should have experience with compulsory savings and audited financial statements for the last three to apply for license as deposit-taking MFIs;
- Management boards, audit committees, and executive directors of MFIs will have to be approved by SBV.

Based on these requirements, Decree 28 will present a number of challenges to microfinance providers. These challenges and constraints will be taken up in Chapter 7 of Volume I and some suggested options will be elaborated in Volume II.

In addition to the constraints immediately identifiable in Decree 28, other constraints that may necessitate regulatory intervention for enhanced microfinance in Vietnam include:

1. There is an urgent need to create and maintain a consistent, updated database of information on all financial institutions serving the market, including asset quality, outreach, funding sources and market segment in order to improve risk management;

2. The absence of a credit reference system (bureau) with at least a loan default registry system or client rating mechanisms potentially increase the risk of over-indebtedness and thus undetected portfolio risk in the well-served market;
3. Regular ratings of medium and larger MFPs/MFIs (formal and semi-formal alike) would improve capital market understanding and confidence in the industry.

With encouraging regulation and clear legal status, transforming MFPs are likely to develop greater capacity to leverage commercial funds, learn from the international experience, and scale up efforts to make their operations more professional. Complying with the new requirements will inevitably entail additional costs and development agencies and other funders can play a role to strengthen transformed MFPs' institutional capacity. In the future, And proper supervision by SBV will also help the institutions. MFIs will need to invest more in training their management and staff and developing accounting and management information systems as increased regulation will require MFIs to adhere to SBV's new reporting standards.

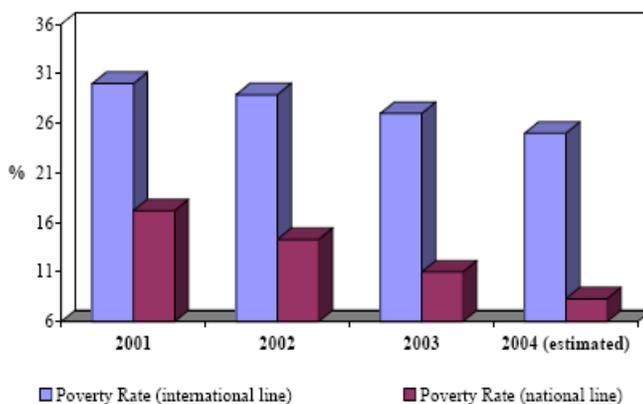
5. The Microfinance Market in Vietnam

A) The Customers of Microfinance

Poor people, especially women, can contribute to wealth creation and improve their own quality of life if they start, maintain or grow a small business, improve the productivity of the soil they till or they can access new and more productive jobs. When poor people do not participate in self-employment or seek to employ others, economies waste human capital and governments incur great expense in supporting poor, dependent populations. But poor people often lack the capacity necessary to become economically independent and they cannot fully access societal resources to help in attaining this goal. Poor people are often under-educated, inexperienced in business, in poor health, saddled with large families they can barely care for, isolated in rural villages or urban slums, or discriminated against because of religion, ethnicity or gender. Poor people also often lack access to the capital necessary to drive existing or potential businesses, for want either of personal assets or collateral, or of financing from friends, family or acquaintances willing to invest. As such, financial services from banks or other formal financial institutions typically elude poor people. This is the background for microfinance – specialized financial services for the poorest segment of the population – the Bottom of the economic Pyramid (BOP).

The planned and thus well-documented economy of Vietnam greatly facilitates the identification of the BOP target group for microfinance. Households are classified by level of poverty in geographic areas graded as more or less developed, accessible and urbanized²⁵.

Figure 5.1 Poor Household ratio in recent years (%)



Using the current national income poverty line²⁶, the overall poverty rate in 2004 has declined from 23% in 2002 to 18.1% of the population²⁷ or some 15.3 million people in 3.5 million households²⁸. Of these, an estimated 8.3% or 7 million people in 1.6 million households subsist on or below the old national

²⁵ E.g. Poverty Mapping and Market Access in Vietnam: Inter-ministerial Poverty Mapping Task Force, October 2003.

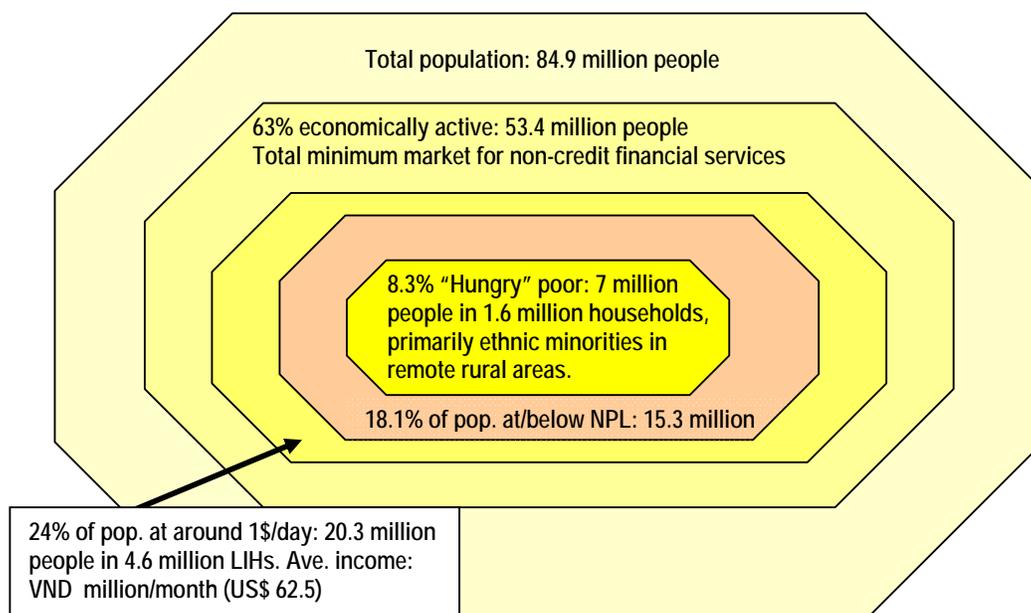
²⁶ Through the Prime Minister's decision 170/2005/QĐ-TTg, the national poverty line was revised upwards in 2005 to VND 200,000 (US\$ 12.5) per capita/month for rural areas and VND 260,000 (US\$ 16.25) per capita/month for urban areas.

²⁷ GSO: "2002 and 2004 poor household rates by poverty line standard applied for period 2006-2010" as published on www.gso.gov.vn on 09 August 2005.

²⁸ GSO reports the average size of a household to be 4.4 people.

poverty line of VND 80,000 – 150,000/month and are classified as ‘hungry poor’, i.e. households with food shortages²⁹. If the international poverty line of US\$ 1/day (VND 480,000/per capita/month) is applied, the percentage of poor people increases to around 24% of the population³⁰ or 20.3 million people in 4.6 million poor or Low-Income Households (LIHs) representing the ‘bottom of the pyramid’ or BOP.

Figure 5.2 The structure of poverty in the population of Vietnam



74% of these LIHs (3.4 million households) are reported to reside in rural areas³¹, and are predominantly engaged in primary agricultural crop production (rice, maize, vegetables and cash crops) and raising of small livestock (chicken, ducks, fish, pigs), selling any surplus at the local markets.

Earnings from agriculture still provide 56 % of the income of poor people (2004) overall, but earnings from wage employment contributes most substantially (by almost 50%) to the growth in the incomes of the poor - at least for the majority Kinh people. People in richer quintiles typically have a more balanced range of income sources, with non-farm self-employment representing around 25% of total income against only 8% for the poor³².

A majority of the urban poor live in areas with poor infrastructure and limited access to utility services (safe water, adequate water drainage, lighting and garbage collection, etc.) in the Mekong and Red River deltas³³. Many are unregistered migrants from rural areas, who often

²⁹ IMF: Viet Nam: Growth and Reduction of Poverty - Annual Report of 2003-2004, February 2006 from which source Figure 3.2 is also taken.

³⁰ Ibid.

³¹ IMF: Op cit., statistical annex, figures from 2004.

³² WB: Taking Stock, June 2006.

³³ Taking Stock, Dec 2005 and GSO press release 09 August 2005, op.cit.

find it difficult to secure permanent residence registration and, as a consequence, have very limited access to the (subsidized) basic social services (health care, education etc.) and to financial services which are enjoyed by registered residents³⁴. The majority of the urban and peri-urban poor depend primarily on cash income from unstable jobs in the informal sector, supplemented by garden- or community land farming.

The highest incidence of poverty is found among the ethnic minorities (61% of all ethnic minorities are poor against only 14% of Kinh and Chinese) and in the Highlands, particularly the mountainous North West (46.1% poor as compared to 12.9% poor in the Red River Delta). People in these areas also have less access to basic social services, including education, and generally live in larger households and have more children, which compounds their poverty. The poorest people in Vietnam are thus members of the country's 53 ethnic minority groups, who depend mainly on agriculture and forest resources for a livelihood - they constitute only 13% of the population but account for almost 30% of the poor.³⁵

At least 35% of the poor engage in non-farm household enterprises (NFHEs) typically alongside farm work. NFHEs are embryonic SMEs and participation in a NFHE is not only associated with a higher standard of living but actually also improves household expenditure levels (ability to spend). In Vietnam, urban households are more likely than rural to engage in NFHE self-employment, e.g. petty trade. Within rural areas, non-farm self-employment has been less common where agricultural extension programs are more active, perhaps a proxy for the greater profitability of farming in these areas (or for extension programs being directed to the poorest areas of the country), but the presence and frequent operation of a local market increases the probability that a household will operate a business from an (assumed) baseline of 45% to 57%, whereas the real sales price of farm crop produced (e.g. rice) is unrelated to this probability³⁶. NFHEs remain a very important source of employment and income in Vietnam, providing an attractive alternative to farming in rural areas, and often the only option for the urban poor, whose lower education and skill levels may hinder their absorption into more attractive wage-paying jobs in the growing formal sector.

While the rapid increases in income will move poor families toward self-sufficiency, acquiring assets is the key to their achieving economic security. Assets act as insurance against economic uncertainty and as wealth accumulation to prepare for future expenses. It is also essential as collateral for access to conventional credit. Material assets in Vietnam comprise primarily land and livestock. A moveable property registry is being established and it may facilitate the use of other assets as collateral.

Although the government remains the single owner of land in Vietnam, a policy was instituted in 1988 to grant long-term rights to households to use the land for economic purposes, including as collateral for credit, and over 10 million Land Use Certificates (LUC) have been issued to date.

³⁴ Ministry of Planning and Investment: The Poverty Situation in Viet Nam. www.mpi.gov.vn Most financial institutions require a residence card in order to open a savings account or provide a loan.

³⁵ IFAD: IFAD in Vietnam, August 2005.

³⁶ Vijverberg, W. and Haughton, J.: 'Household Enterprises in Vietnam – Survival, Growth and Living Standards, World Bank Policy Research Working Paper 2773, February 2002. The prevalence of NFHEs is estimated to have grown since the study, which is based on data from the 1998 VHLSS.

In 2002 the overall average land holdings per household did not differ markedly between the poorest (4,778 m²/HH) and the richest (4,867m²/HH) quintile of the population. However, the wealthier segments had significantly more rights over the more productive perennial crop land and fish ponds, while forest land is more typically an asset of the poorest³⁷. Due to limited irrigation, the productivity of arable land is lower in the mountainous areas than in the fertile lowlands, but in both areas, the poor are more adversely affected than more well-endowed households by floods, droughts and insect infestations. This correlates with the finding that the capability to rely on non-farm sources of income, e.g. a micro business, is in general associated with low(er) poverty.

Landlessness in Vietnam has increased to 14% in 2004 from 7% in 1993, raising the Gini coefficient measuring inequality in landholdings from 0.49 to 0.65³⁸. Importantly, however, and despite regional differences (the exception being the Mekong Delta), there is little correlation between landlessness and increased poverty – more better-off households are landless than poorer ones, and increased landlessness thus reflects the move out of agriculture and the migration towards urban employment opportunities. The urban-rural poverty gap remains the largest disparity in Vietnam; in 2002, urban households were able to spend 78% more than rural ones³⁹.

Apart from land and housing, the most important asset of households in Vietnam is livestock. Most peri-urban and rural households, particularly in the mountainous areas, the Red River delta and along the central coast own livestock; primarily pigs (47% of households) which generate the highest average livestock income across agricultural households, and chicken (51%). Livestock holding in cities is associated with higher poverty, although the urban dwellers with livestock are still less poor than their rural peers. In rural areas, where dependency on farming activities is perhaps inevitable, commercially oriented farming, livestock ownership, production efficiency and market exposure are the key factors associated with higher income. Commercialization of agriculture has increased in rural Vietnam; in 2002, rural households were selling 70% of their farm output, up 22% since 1993. The poorest households have more access to livestock than to land but are also less integrated in the market and less production efficient. The poverty gap confirms that the direct key drivers to reduce poverty are diversification of agricultural production and activities outside of farming and livestock production⁴⁰ supported by developing entrepreneurial skills and sound business environment.

Generally, and also in Vietnam, the existence and development of infrastructure reduces poverty, and irrigation, high-value crops (e.g. coffee and other tree crops, shellfish or fish in addition to rice) and a local market presenting income generating opportunities from non-farm activities affects both farm and non-farm income generation positively. Market-, infrastructure- and business development thus continues to be a necessary ingredient in the fight against poverty in Vietnam – credit alone cannot lift the BOP out of poverty.

³⁷ Vietnam Development Report 2004: Poverty. Joint Donor Report to the Vietnam Consultative Group Meeting, December, 2003.

³⁸ WB: taking Stock, June 2006.

³⁹ Vietnam Development Report 2004: Poverty. The VSSL survey measures poverty in terms of expenditure.

⁴⁰ FAO: The Contribution of Livestock to Household Income in Vietnam: A Household Typology based Analysis, PPIPL Working Paper No. 21, June 2005; and Vietnam Development Report 2004: Poverty.

B) The Demand for Microfinance Services

The vast majority of the 4.6 million Low-Income Households subsisting at a monthly income of around VND 1 million (US\$ 62.5) or less per month in Vietnam today live in medium-sized, male-headed families in the rural areas, surviving on subsistence agriculture. Most (86%) of these households⁴¹ have access to land and most farm the land and/or raise livestock. In addition to farming, at least 35% operate non-farm household businesses, and are better off for it⁴².

Like most people, this segment of the population encounters many occasions during their lives when they need sums of cash greater than they have at hand to pay for major life events (weddings, funerals), take advantage of a business opportunity, and as a cushion against sudden shocks, such as illness or a bad harvest.

The most reliable way for the poor to get hold of such sums is through savings; either formal voluntary deposit services in the financial sector or with informal but reliable deposit takers; in savings clubs; or in-kind, through holding precious metals, livestock, or cash at home. The poor also obtain advances against future savings (loans), and as such credit is one of the means that poor people have for converting future savings (repayments) into the lump sums that they need for investments (assets); working capital (operations, stock); consumption, absorption of external shocks and income stream smoothening over the year (e.g. in between harvests and sales of crops).

The provision of financial services for the poor (microfinance) thus consists of mechanisms by which they can turn small and variable savings into lump sums for a wide variety of uses (and not just to run micro enterprises). Good financial services for the poor are those that do this in the safest, most convenient, most flexible and most affordable way⁴³.

a) Nature of the Demand for Microfinance

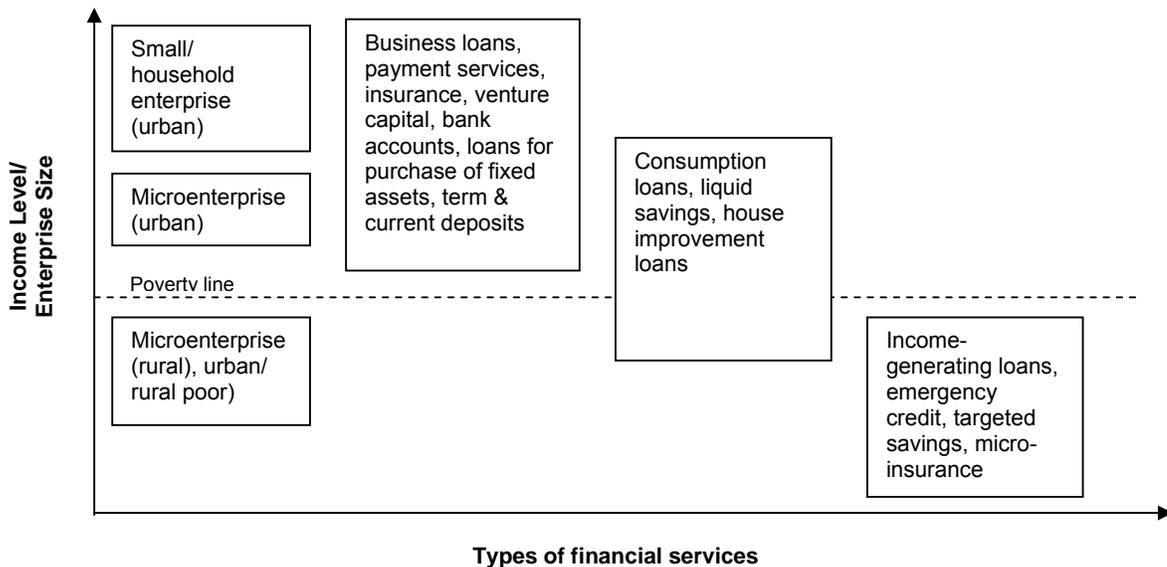
The nature of the demand for financial services among the 4.6 million Low-Income Households in Vietnam is much more complex than standardized programs are designed to respond to, and varies significantly with the size of business and the income level of households. The demand for financial services, and credit in particular, also varies with the type and location of the activities in which the customers engage – a rural crop producer and an urban petty trader will have very different demands. While a small loan can certainly make a significant impact in raising the income-generating capacity of a rural poor household, urban households and micro-enterprises have different characteristics and hence different needs, as illustrated in Figure 5.3:

⁴¹ As microfinance is normally serving only one member of the household, but benefiting the entire family, the market size is often given in number of households.

⁴² Vietnam Development Report, 2004: Poverty.

⁴³ For an overview of informal savings mechanisms, see Rutherford: *The Poor and their Money*, 1999.

Figure 5.3. Demand for Financial Services among BOP⁴⁴



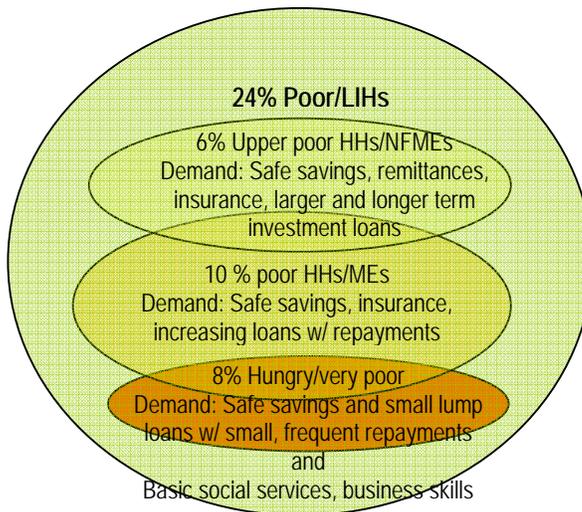
In Vietnam, micro-credit has often been interpreted as the provision of subsidized credit facilities for the poor and quantitative ‘coverage targets’ are being promoted in response to a perceived unmet demand for ‘credit’ among the rural poor. This results in supply-driven efforts, led by GoVN with the participation of many donors, INGOs and NGO programs which are manifested by embedded revolving credit funds in otherwise well-focused community development and social mobilization interventions. Comparatively less attention is being paid to the quality of the debt finance provided, the sustainability of the institutions providing the service, and the repayment capacity of borrowers.

Contrary to small deposits, remittances and insurance products, credit is not an appropriate or desirable financial product for everyone. From the perspective of poor clients, it is the *permanent* access to financial services that is the most important consideration, and not interest rate levels, as this helps them take advantage of opportunities and manage risks, as opposed to ‘one-off’ loans or ‘stop-and-go’ credit available as and when supply-led institutions, like the VBSP or INGO programs, succeed in raising external capital. The chief motivation among BOP customers for repaying a loan is the promise of future access to more and larger loans and this is often re-enforced with social collateral such as group guarantees. This explains why microfinance can operate successfully in the informal sector without physical collateral, enforceable contracts, and commercial courts, and provides the background for the typically excellent repayment rates among the poor.

Demand for *credit* should not be confused with the need for ‘money’ among the poor to fulfill their basic consumption needs – nor with the number of ‘eligible households’ holding a Low-Income Certificate (LIC). The demand for credit in terms of loan sizes differs between very poor and less poor households. This segmentation of demand (see Figure 5.4) is rarely recognized by supply-driven financial service providers.

⁴⁴ Mai lan le & Nhu An Trang: *Entering a New Market: Commercial banks and Small/Micro Enterprise Lending in Vietnam*, ILO Vietnam Working Paper Series No. 3, 2003.

Figure 5.4: Segmented Microfinance Market Demands



Without an income generating household activity, credit can over-indebt households, making them poorer. Among the very poor, the lump sums demanded and borrowed against future savings (repayments) need to remain within the savings capacity of the households, which is limited and varies over time. Because of the difficulties in managing this cash flow, large and long-term loans are not very desirable, and the very poor seldom demand ever increasing loan sizes at regular intervals. However, if (cheap) credit is easily available, even

very poor households will often be tempted to take more credit than they would at market rates – and more than they may be able to repay (although it is known that government-provided credit is often seen as a form of grant which does not have to be repaid). This leads to potential over-indebtedness among the poorest and to exclusion due to rationing of credit for borrowers able to absorb larger loans.

The often cited demand for larger loans at longer terms is primarily voiced by the less poor and more experienced customers of credit programs⁴⁵ in areas where ongoing local economic activity generates sufficient household cash flow, and borrowers use loans to *grow* a profitable business or productive activity, rather than establish it.

Because the financial services available in Vietnam are not very well-adapted to their growing needs (demand) and very few providers are able to fulfill all aspects of household demand, many households within this ‘upper segment’ of the poor, who can benefit from larger and longer loans, compose a package of services from several providers to meet their financial needs, and thus multiple borrowing is widespread. As these customers have a stronger voice and a choice, price- and quality sensitivity is growing and thus the cheaper (more subsidized, e.g. from VBSP) or the credit delivered more conveniently (e.g. from semi-formal MFPs) will appear to be in higher demand, and is frequently quoted especially by capital-constrained MFPs and VBSP in support of a ‘huge unmet demand.’ Demand for credit will increase as growth and economic opportunities increase. However, the vast majority of the customers in this segment could – and do – access formal financial services to meet their growing demand. They should be graduating and be made ineligible for VBSP loans, as long as the interest rates remain subsidized.

⁴⁵ For a differentiation of demand for loans, see Simanovitz: Microfinance for the Poorest: A review of issues and ideas for contribution of *Imp-Act*.

In addition to conventional micro-credit, farmers and processors in agriculture, fisheries and some services in Vietnam are demanding *micro-leasing* products, which would enable micro-entrepreneurs to obtain the use of a high-cost piece of equipment and pay only for that part of the cost of the services used, thus requiring smaller loans. *Micro-leasing* is also frequently demanded for group-based agriculture where members of a farmer's group or cooperative jointly lease a larger piece of equipment, e.g. a tractor and use it in turns, contributing a proportional part of the cost.

Poor people can save and want to save, and when they do not save it is because of lack of opportunity rather than lack of capacity. Over time, *savings* can grow to build assets for investments, and poor households in Vietnam demand savings products that are safe; accessible (liquid); and interest-bearing. The purpose of micro-savings services in an inclusive financial system is to provide poor people with a safer alternative to the informal savings mechanisms that are often high risk.

The vast majority of the rural farming households would also benefit significantly from access to appropriate micro-insurance services, including in particular medical, life, property, livestock and crop (price index) insurances. *Microinsurance* products are not simply downscaled conventional insurance products where "one product fits all". Microinsurance is a subset of insurance that provides financial protection to the poor for certain risks in a way that reflects their cash constraints and coverage requirements. It is a risk management system for low-income groups in which individuals, businesses, or other organizations pay a certain sum of money (a premium) in exchange for guaranteed compensation for losses resulting from certain perils (economic shocks) under specified conditions. In return for the payment of small amounts of premium, low-income households can access e.g. health services or cover funeral expenses without having to draw down on their assets.

Remittances are also an importance financial service for a growing number of BOP households. With the growing number of Vietnamese going overseas to work and sending money home, many rural families depend on reliable and convenient access to points of receipt of these contributions.

Financial service providers thus need to adapt their services to each market segment in order to meet these diversified needs. Standardized approaches and loan products based on ease of management and delivery may be acceptable for low income individuals, closer to "graduating" to commercial banking, but they are not what the poor need. But product development designed and adapted in terms of loan size and timing and repayment conditions for the lower segment of the poor is only slowly evolving among the microfinance providers in Vietnam.

Finally, customers in rural areas of Vietnam that are less linked into the market are also demanding better access to complementary *non-financial services* to improve their businesses, including training in business and financial management; vocational/production-related training and transfer of new/improved technologies; market access, market information and communication, etc. There appears to be a large and growing market among low income people in rural areas for high-quality business development services (BDS) that is not currently being met either by formal or semi-formal microfinance providers.

b) The Present Market (Demand) Estimates

Like everywhere else, the poor in Vietnam face constraints in accessing formal financial services, including limited access to voluntary deposit services; lack of sufficient collateral for loans; and lack of means to service loans according to the banks' preferred schedule (payment of principal at the end of the loan). In addition, not all remote communes have access to formal banking services and the poorest lack the confidence to confront a bank and may have limited production potential. The difficulties in accessing credit are obviously related also to some factors that are intrinsic to poverty (lack of viable economic/business opportunities, lack of business plans) that make these customers appear risky in the eyes of the formal lending institutions (even though it has been established that repayment records are generally good). Nevertheless, it is a fact the market segment of the poorest is the least well served; both in terms of outreach and in terms of the appropriateness of the products on offer.

Unlike many other countries, however, the market penetration (financial depth) of formal financial services providers (financial deepening) in Viet Nam is remarkable at 84% (M2/GDP) up from 46.5% in 2001⁴⁶. When considering all sources of credit, including private moneylenders, informal savings and credit groups and friends and relatives, the financial sector today is responsible for close to two thirds of the financial resources mobilized in Viet Nam, and total credit represents more than 60% of GDP. Combined, the largest providers, VBARD, VBSP and the PCF network report to reach approximately 14 million households (or about 61 million people), although there is a degree of double counting involved and not all recipients of financial services can be considered as poor, as the report will show.

(a) Resource Mobilization (MicroSavings)

Based on the BOP segment estimate in Figure 4.2 above, the market for *non-credit financial* services would thus include all Low-Income Households or **4,630,500 households**, who may not all use, but should all have access to these services in order for inclusive finance to have been attained in Vietnam.

The growth in mobilized deposits in the formal financial sector in Vietnam has averaged 30% per year over the past 3 years, but it has been larger in some years in the case of the largest state-owned commercial bank, VBARD. By May 2005, total national currency deposits in Vietnam amounted to US\$ 20.2 billion⁴⁷. The formal financial institutions hold roughly 25 million active savings accounts⁴⁸, of which the largest provider, VBARD reportedly holds 17 million (68%) of these accounts, 10 million of which are term deposits.

With their high average deposit balances (US\$9,494 for JSCB responding to the survey), the majority of the current bank depositors in Vietnam are not in the BOP category, and BOP

⁴⁶ Economics@ANZ: Examining the Vietnamese Dong, August 2006.

⁴⁷ IMF Country Report 06/52, Statistical Appendix (table 20), February 2006.

⁴⁸ Viet Nam Development Report 2006: Business. The estimate of savings accounts was compiled by the World Bank based on annual reports from banks and other sources.

customers rarely hold term deposits. But the extensive branch network of VBARD, the Vietnam Postal Savings Company (VPSC) via the post offices and the growing network of People's Credit Funds do in principle ensure access by most BOP households to formal sector savings services in close proximity of their residence. However, many rural households and in particular the poor have not yet forgotten the losses they incurred in the late 1980s when the former credit cooperatives collapsed, and may be reluctant to entrust their limited savings to large and impersonal financial institutions. This, along with limited marketing and a tradition (both among rich and poor alike) to hold substantial cash on hand, could explain the low ratio of savings from poorer rural households in the VPSC, and the apparently relatively high level of BOP savings kept at home despite the relative broad geographic outreach of formal financial institutions in general.

As of the end of 2005, the dominant provider of deposit services to rural BOP households (if not to the poorest segment), VBARD, reportedly held US\$ 7.5 billion in customer savings deposits, up 31% from 2004⁴⁹, of which 58% or around \$ 4.35 billion are deposits from the bank's estimated 5.4 million individual and household customers at an average value per account of VND 12.8 million or US\$ 805⁵⁰. The total savings deposit of the PCF network is much smaller, at around US\$ 340 million in about 1 million accounts (average balance per account US\$ 340)⁵¹, and the VSPC held US\$ 44.6 million in 80,000 ordinary savings accounts (average balance US\$ 557) and US\$ 5.6 million in around 50,000 'collection accounts' with monthly deposit and withdrawal rights, which better suit low-income earners, as illustrated by the average savings balances of US\$ 112⁵². The non-regulated (semi-formal) microfinance providers (MFPs) in Vietnam report a total of US\$ 19.6 million in 335,408 voluntary savings accounts⁵³, the average balance of US\$ 58 illustrating their deeper outreach. The policy lender VBSP which targets poor and disadvantaged households directly, reported to hold VND 935 billion or US\$ 58.5 million in 167,285 savings accounts as at end 2005⁵⁴ (average balance US\$ 350).

Table 5.5 Adjustments and estimates of BOP savings accounts

Provider	Total accounts to HHs/individuals reported	Adjustment for non-BOP and duplicate accounts	Total estimated BOP savings accounts
VBARD	7,000,000	4,900,000 (70%)	2,100,000 (30%)
VPSC	501,900	401,520 (80%)	100,380 (20%)
VBSP	167,285	83,640 (50%)	83,645 (50%)
PCFs	1,000,000	600,000 (60%)	400,000 (40%)
MFWG members	335,400	0	335,400 (100%)
Total	9,004,585	5,985,160	3,019,425

Adjusting for non-BOP accounts among the formal institutions and for the significant level of double-counting of customers (households holding accounts in more than one institution⁵⁵) in the Vietnamese market, it would appear that these financial service providers together may

⁴⁹ VBARD's survey questionnaire as compared to the Annual Report 2004.

⁵⁰ Interview with VBARD management on 27/7/2006.

⁵¹ SBV: Summary Report of the PCF's Performance March 31 2006 and CCF's Annual Report 2004-2005.

⁵² Vietnam Postal Savings Company: PowerPoint presentation, Hanoi, July 2006 and interview on 28/07/06.

⁵³ MFWG: Basic Data on MFOs As of 31 March 2006.

⁵⁴ VBSP response to Survey and interview with management on 27/07/2006, follow-up email 05/09/2006.

⁵⁵ Based on the evidence from the field research and other research data that at least 50% of all clients have more than one savings account, the adjustment added 30% of VBARDs accounts, 40% of the PCF accounts, the collection accounts of VPSC, 50% of VBSP's accounts and 100% of the MFP accounts to arrive at this figure.

provide savings services for around 3,020,000 individuals representing BOP households, which constitutes an impressive 65% of the total estimated number of LIHs (BOP) in Vietnam. The available instruments are complemented by the informal financial intermediation of small savings. With the expansion and growth plans of the major providers and the transformation of the largest semi-formal MFPs to deposit-mobilizing Microfinance Institutions under Decree 28, the supply of savings services seems poised to continue to grow and to eventually diversify into more sophisticated saving and investment instruments.

In Vietnam, the issue for enhancing savings services is not so much quantitative outreach expansion except in the remote, rural areas, as it is market-responsive adaptation and product development to provide the existing BOP customers with safe, convenient and flexible (liquid but interest-bearing) savings services with low minimum-balances that the poor generally prefer. Commercial banks may not find this market very attractive when they can grow their resource mobilization more quickly in urban areas. But the present low-value, high-volume deposits from BOP will also grow through time and the microfinance providers that develop a focus on customer-care and product adaptation will be those that will benefit.

(b) Lending (Micro-Credit)

The focus of the GoV on provision of (subsidized) credit as a preferred poverty reduction instrument has led to a widespread consensus that there is a growing and unmet credit demand among BOP in Vietnam. In response, a high number of very diverse institutions have supported the relatively supply-driven roll-out of standardized credit products to BOP nationwide, although in value terms, the supply has been concentrated in VBARD and VBSP.

Micro-credit is an important service for BOP households that can productively use and gainfully benefit from credit to grow their businesses. But contrary to small deposits, remittances and insurance products, credit is not an appropriate or desirable financial product for everyone, and *not all poor households need or can benefit from credit*. In particular for the very poor in remote areas, the ability to utilize credit for gainful enterprise, earn a profit and repay the loan must be carefully assessed to avoid increasing their debt. In addition, the informal credit market where households borrow from friends and family continues to be important in Vietnam, and will for some households be a preferred (and usually cheaper) option.

Adjusting for these factors, we estimate that 25%⁵⁶ of the economically active 4.6 million Low-Income Households would not be interested in or able to use credit profitability at this stage. Thus, the total potential market estimate for inclusive debt finance is about **3,470,000 economically active, low-income households** demanding and able to utilize micro-credit services, of which 2.56 million (74%) reside in rural areas.

Most conventional commercial banks like to focus on high value-low volume customers and in Vietnam in particular commercial banking relies heavily on physical collateral or guarantees.

⁵⁶ Based on the industriousness and widespread use of credit in Vietnam, this adjustment has been set low. In many other countries, it is commonplace to adjust by 50% to attain a market estimate for credit.

Few banks have the interest, structure, systems and tools in place to adequately price risk and appraise, monitor and manage a high volume-low value and non-collateralized micro-credit portfolio, which is seen as high-cost and high-risk. Thus, despite the fact that default rates in microfinance are much lower than in the formal banking system, few banks seem to find profitable to go downscale, possibly because of their inability to price risk appropriately. The urban micro-market is primarily served by PCFs, the VBSP and some MFPs at present. In the rural areas, VBARD, VBSP, many PCFs and the MFPs constitute the main providers of BOP credit, complemented by a vibrant informal market of credit provided by traders, local shops, money lenders, and a plethora of savings- and credit groups, of which many but not all are founded in membership of socio-political mass organizations.

As an agricultural bank, VBARD has specialized in lending to rural households and SMEs involved in agriculture or off-farm enterprises. VBARD reported a total credit portfolio of 9 million loans at a value of \$ 11.8 billion As of mid 2006 (average balance US\$ 1,320), of which 68% was allocated to rural households, of which 47% were considered poor households⁵⁷. The PCF network serves 1 million members with loans of an average value of US\$ 700-800⁵⁸. Set up specifically to serve poor households, VBSP reports a total portfolio of 3.8 million poor borrowers provided with loans at a significantly lower average value of US\$ 280⁵⁹. And the non-regulated (semi-formal) microfinance providers (MFPs) targeting the poor in particular, report a total loan portfolio of US\$ 47.4 million outstanding with 284,400 borrowers borrowing an average of US\$ 166 each⁶⁰.

Table 5.6 Adjustments and estimates of BOP loans

Provider	Total accounts to HHs/individuals reported	Adjustment for non-BOP and duplicate accounts ⁶¹	Total estimated BOP loans
VBARD	9,000,000	6,123,600 (68%)	2,876,400 (32%)
VBSP	4,125,000	2,062,500 (50%)	2,062,500 (50%)
PCFs	1,000,000	750,000 (75%)	250,000 (25%)
MFWG members	284,400	142,200 (50%)	142,200 (50%)
Total	14,409,400	9,078,300	5,331,100

As for savings services, there is a need to adjust these numbers for non-BOP accounts of VBARD and the PCFs and for the high level multiple borrowing. Even with a relatively aggressive adjustment (see Table 5.6), it appears that these financial service providers together may provide credit to some 5.3 million BOP borrowers. This constitutes 26% of all Low-Income people in Vietnam, but 115% of all LIH households and 54% more than the estimated market for credit services.

Micro-loans (up to VND 10 million) are quite easily available to farmers and micro-businesses, reflecting government policies of using subsidized credit instruments to facilitate social transfers in the fight against poverty. Indeed, as documented by numerous financial sector reports, most poor and low-income households have access to some form of credit, and

⁵⁷ Interview with VBARD management on 27/7/2006.

⁵⁸ Interview with CCF on 4/8/2006.

⁵⁹ VBSP: Annual Report 2004 and interview with management on 12/07/2006.

⁶⁰ MFWG: Basic Data on MFOs As of 31 March 2006.

⁶¹ Authors' estimates based on mission's findings and interviews with institutions

the formal banking system appears to reach a substantial number of them. Customers, and especially the poorer among them who are eligible for targeted (and subsidized) credit programs, do have a choice of providers, and this has increased the sensitivity to interest-rates and quality. Very few people indeed are fully excluded from access to some form of financial services. Contrary to perceptions, the 'unmet demand' in Vietnam is very small, and it is not very significant within the traditional *microfinance* market.

The relatively high level of outreach achieved for micro-credit in Vietnam raises concerns on three accounts:

- possible 'over-heating' in the BOP credit market in some areas, where even poor households can easily obtain more than one loan. This may increase the risk of over-indebting poor households and increase the systemic risk of portfolio collapse;
- the un-quantified but real possibility that many new loans, particularly by VBARD and VBSP (but to some extent also in PCFs) simply refinance ("turn-over") existing loans, as providers do not coordinate and compare client portfolios and there are no credit reference systems, no client rating or other early-warning systems,
- in particular, the ethnic minority communities in remote areas are not yet well served, which indicates weaknesses in the geographic distribution of credit provision and the need for increased coordination, mapping and consolidation of client IDs to determine which areas and customer groups are underserved.

In fully market-driven economies, the portfolio risks associated with warnings of over-indebtedness can be mitigated by providers adjusting (raising) their interest rates, thus increasing the cost of accessing credit, assuming that only those that really need and can use credit will apply for loans at the higher cost. However, interest rates in Vietnam do not fulfill this role. Therefore, the supply-driven focus on micro-credit provision to 'anyone, anywhere' without enhanced knowledge of the market must be reconsidered.

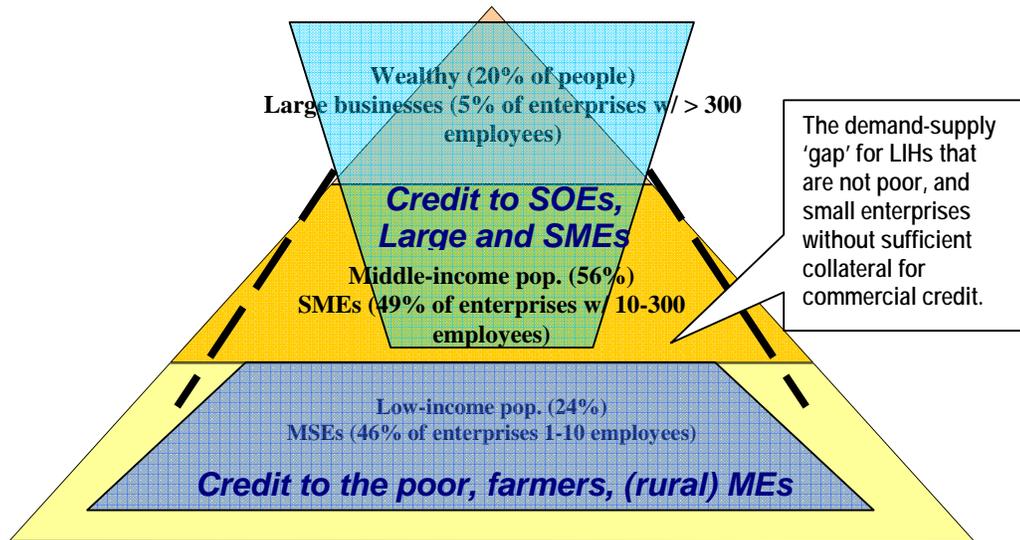
For more sizeable micro- and small businesses (MSEs) using the formal financial providers, collateral is required and it is valued in a very conservative way. Delays in the issuance of Land Use Certificates and in the general implementation of regulations for secured transactions further limit access to credit. Heavy reliance on collateral is the flip side of the current limited (capacity for) risk assessment by the dominant formal sector lenders.⁶² And the engine for economic growth in Viet Nam: the small- and medium-sized enterprises (SMEs) consistently state that insufficient access to finance is the most important obstacle to business growth, and the share of firms that see it as a "severe" or "major" constraint to their development is significantly higher than in other Asian countries.⁶³ This apparent contradiction stems from a market mismatch, especially for credit, as illustrated below.⁶⁴

⁶² Viet Nam Country Development Report 2006: Business.

⁶³ World Bank: Doing Business. Vietnam Country profile/survey, 2005.

⁶⁴ Figures and classification of enterprises from Vietnam Chamber of Commerce and Industry: Business Issues Bulletin, No. 8, June 2005.

Figure 5.7: An illustration of the Supply and Demand of Credit in Vietnam



(c) Other Microfinance Services

Remittances are available from most regulated financial service providers, either directly or through agent arrangements with specialized providers such as Western Union and MoneyGram, as well as from a large network of informal providers. However, remittance services are not well integrated within the banking system and are not used to expand customer services. The availability of debit and to some extent credit cards is also growing rapidly. With the extensive branch networks of the dominant providers in the market, there does not appear to be a significant BOP supply-demand gap.

Micro-enterprises also benefit from embedded finance services, such as *pre-financing of inventories or inputs* (seeds, seedlings, fingerlings, fertilizer, pesticides etc.). To some extent, local traders in the rural informal sector of Vietnam are offering these services. For the providers of Business Development Services (BDS) in Vietnam, the structure and development of such embedded financial services merits attention, especially because they are easily distorted by external grant-funding that limits the market for commercially viable business solutions in the market place.

Micro-leasing has not yet been developed to any extent. The nine leasing companies in Vietnam focus on services and transport in the urban SME-segment of the market, rather than BOP. Leases average US\$ 90,000. Without a moveable property registry in place yet and with limited property rights, the services will not expand at a rate at which they could.

The *insurance industry* has only recently begun expanding, and a series of policy and market changes have taken place over the past two years fostered by increased competition. Starting from a very low base, growth rates of mainly life insurance are impressive. While micro-insurance products are severely under-developed in the young industry in Vietnam, the

Government is providing social insurance and low-cost medical insurance to LIHs. It is encouraging that several life, agricultural (crop, livestock) and accident insurance products are currently being piloted in collaborations between JSBs, MFPs and the insurance industry.

By all accounts, the demand for insurance services among BOP households, including agricultural insurance, is potentially huge and largely unmet. On the demand-side, awareness is low and perceived pricing of premiums is higher than actual costs; and on the supply-side, the potential size and profitability of BOP market segment is not fully recognized and the process of designing and testing cost-effective services and delivery systems accessible to BOP is only just beginning.

C). *The Structure and Performance of the Supply Market*

a) *The Institutional structure of the Supply Market*

The formal financial sector in Viet Nam is supervised by the State Bank of Viet Nam (SBV), which has branches in all 64 Provinces of the country and the Deposit Insurance of Vietnam (DIV) which issues deposit certificates to financial institutions and manages liquidations of failed banks and PCFs⁶⁵.

In the initial stages of Vietnam's economic transition, banks were mainly serving as government windows to channel resources to State-Owned Enterprises (SOEs), and individuals did not use the banking system to any large extent. In 1993, 40% of loans in rural areas were from private individuals, 33% from private money lenders, and only 25% came from banks and other formal sources⁶⁶. However, formal sector bank credit increased as a proportion of GDP from 27% in 1995 to a peak of 42% in 2004 and of this, credit to the private sector increased from 18% in 1992 to about 66% in December 2004. Due both to the inflationary pressure and concern about the quality of the rapidly expanding credit, overall credit growth has slowed since then to around 32% in December 2005, and 25% in February 2006, and credit to the private sector slowed from 45% to 35% year-on-year from end 2004 to end 2005⁶⁷.

Today, the four main (and one smaller) State-Owned Commercial Banks (SOCBs) dominate the financial sector, accounting for 86% of credit and of total assets (2005) in the banking system. In addition, there are 36 Joint Stock Commercial Banks (JSCBs), which in Vietnam are referred to as Rural and Urban Shareholding Banks respectively) mainly serving SMEs and representing 20% of total credit; 4 Joint Venture Banks (JVBs); 28 foreign bank branches⁶⁸; and a few fully-foreign owned banks, which together account for around 10% of banking credit.

The conventional formal banking sector is complemented by two financial institutions, which offer subsidized credit ("policy lending") to specific sectors of the economy and are regulated

⁶⁵ DIV: Annual Report 2005: Report on 2005 Operations and Business plan for 2006.

⁶⁶ 1993 Viet Nam Living Standards Survey (VLSS) quoted in Viet Nam Development Report 2006: Business.

⁶⁷ Viet Nam Development Report 2003, State Bank of Vietnam: Annual report 2004, and World Bank: Taking Stock, June 2006.

⁶⁸ State Bank of Viet Nam: 2004 Annual Report.

by SBV and other government agencies under their own specific Decrees: the Vietnam Bank for Social Policies (VBSP) and the Vietnam Development Bank (VDB). Six sectoral 'financing companies' with limited banking licenses including the Vietnam Postal Savings Company (VPSC) and 9 leasing companies affiliated with SOCBs or foreign banks complete the ranks of the regulated financial institutions, whose services are complemented by the regulated insurance industry.

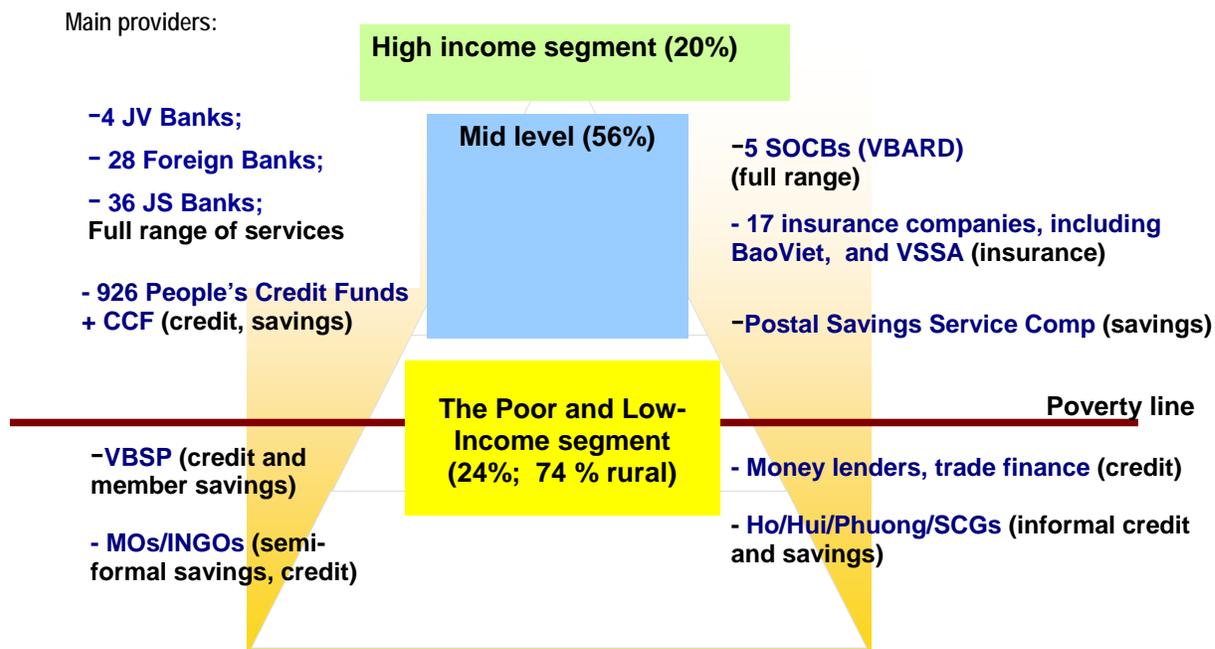
The Vietnamese microfinance market is characterized by the dominance in scale and depth of three regulated providers, namely VBARD, VBSP and the network of 926 People's Credit Funds (PCFs). The latter having emerged as regulated savings and credit cooperatives after the collapse of the old cooperative system in the late 1980s. These main providers all pursue the market for small, particularly rural loans, but with very different approaches.

The poorest are served by semi-formal microfinance institutions, primarily (I)NGO and donor-programs in partnerships with the socio-political Mass Organizations. The Women's Union, Farmers Union and the Youth Union with a combined membership of about 20 million play a key role in microfinance by managing group loan and savings schemes; implementing INGO-supported microfinance projects; and linking clients to VBARD and VBSP, as do the Labor Union, Farmers' Union and the Veterans' Union.

Complementing this supply, a plethora of local, semi-structured and truly 'private' informal finance mechanisms exist in almost every hamlet of Vietnam as a well-integrated part of the communal safety net.

Below is a graphic illustration of the current providers of financial services in the Vietnamese market organized following the *primary* market-segment they serve. Annex 1 presents a more detailed description of the different institutions that comprise the microfinance sector in Vietnam. It should be noted that while VBARD does not directly target the 'Bottom of the (relatively flat) Pyramid' (BOP) in Viet Nam, this bank dominates the rural credit market, and does serve the poorer segment through its targeted programs capitalized by donor funds and through framework agreements with the Mass Organizations, particularly the Farmers' and Women's Unions.

Figure 5.8: Structure of the retail market



b) The Range of Microfinance Products

The market for financial services in Vietnam is not very diversified, and the majority of providers offer similar and standardized credit and savings products. As the largest provider, VBARD also offers the broadest range of products for its customers, and loans with variable repayment structures for different purposes are available. The range of *credit products* available in Vietnam include:

Table 5.9 Overview of available loan products

	SOCBs	JSCBs	PCFs	VBSP	MFWG
Collateralized loans:					
Consumption loan range (VND)	Max 50 mn	1mn – 1 bn	100,000–130mn	-	-
Interest rate	9.5-13.5%	9 – 15%	9.6-17.4%		
% collateral	50-100%	70-200%	70 – 100%		
Mortgage/housing	Max 70%	5-158bn (max 85%)	1mn-300 mn	Max 200mn	-
	8.5–12.9%	11.4-15.6%	9.6-16.2%	7.8%	
	70-100%	70-167%		100%	
Investment/working cap. (MSMEs) including agriculture (VBARD)	Max. 85%	11-158bn (max 85%)	1mn-180mn	5m-500mn	Max 10 mn
	8.5-12.9%	10-15.6%	9.6-17.4%	9.6%	24%
	70-100%	70-167%			50%
Poor households	-	1mn-50mn	500,000-9mn	Max 15 mn	-
		11.4-15.6%	8.4-16.2%	7.8%	
		70-100%	70-100%	50-70%	
Group loans	-	-	-	Max 500mn	475,000-
				7.8%	9.5mn
				100%	10.32%
					50%
Uncollateralized loans:	SOCBs	JSCBs	PCFs	VBSP	MFWG

Consumption loan range (VND) Interest rate	-	-	100,000–130mn 9.6-17.4%	Max. 10 mn 7.8%	100,000- 1.3mn 9.6-12.2%
Mortgage/housing	-	-	1mn-300 mn 9.6-16.2%	-	Max. 15 mn 14.4%
Investment/working cap. (MSMEs)	Max. 10 mn 9.6-12.9%	-	1mn-180mn 9.6-17.4%	Max. 10 mn 9.6%	285,000- 10mn 9.6-24%
Poor households	-	-	500,000-9mn 8.4-16.2%	Max 15 mn 7.8%	285,000- 15mn 11.3-24%

Given the existence of a specialized rural development bank, VBARD, in the agrarian economy, agricultural loan products are more easily available than in many other countries, where agricultural lending is considered particularly high-risk. VBARD offers investment and working capital loans for annual and perennial crops (rice and rubber, tea and coffee) totaling some 32% of its portfolio; as well as loans for fisheries, livestock (40%), handicraft and trade (10%) and rural infrastructure. Due both to risk adversity and to the restrictions imposed on donor credit line, VBARD does not in general offer emergency loans or consumption loans to poor households.

For commercial loans, VBARD and the other conventional banks will require immovable collateral (land, real estate, LUC) and lend up to a maximum of 85% of the secured value over the medium term to individuals and SMEs. VBARD offers loans below VND 10 million (US\$ 625) to poor farmers and rural households, which are formally collateral-free, but in practice borrowers must often leave their Land Use Certificate (LUC) with the bank until the loan is repaid, or be sponsored (guaranteed) by a Mass Organization. Such small loans are short-term, typically 6-12 months, and interest rates range from 9.6 - 12% p.a. The loan repayment structure varies from balloon lump sums (which would suit seasonal crop producers) to monthly repayments, (which would normally be preferred by the typical petty trade enterprises of many microfinance clients).

VBSP lends primarily to households identified as poor by the LPCs certificate (90% of the portfolio) and to small and medium-sized businesses in remote areas (for employment creation under the Government “Program 120”). For poor households, the maximum loan amount without collateral is VND 10 million (US\$ 625), while collateralized loans of up to VND 15 million (US\$ 937) are also provided. The loan terms do not normally exceed 3 years, and repayments of principle are monthly (for small loans) or quarterly, while interest repayments are monthly.

The ‘bank’ also provides credit to poor students and poor workers seeking employment or returning from overseas. Loans are without physical collateral, but except for Program 120 loans, VBSP enters into framework agreements with Mass Organizations (in particular the Women’s Union, the Youth Union and to some extent the Labor Union), paying a small, performance-based remuneration to the MOs (0.165% of outstanding balance collected on time) for their identification, selection, grouping and monitoring (debt collection) of poor borrowers. As such, borrowers are normally required by the MOs to form guarantee groups and to deposit compulsory savings with VBSP at an interest rate of 2.4% p.a.

Due to their small size, private (member) ownership, and closeness to borrowers, PCFs can usually provide more varied loan products, albeit at higher interest rates than VBARD. The interest rates on loans vary significantly from 8.4 – 17.4% p.a., but loans to poorer members cost an average of 9% p.a. Some PCFs provide lending for education (short-term) and emergency purposes; such services effectively reduce members' reliance on moneylenders⁶⁹.

Most INGO-supported programs use a solidarity-group methodology, either of the village bank or Grameen type, while a few (including the largest MFP, the CEP Fund in Ho Chi Minh City) also provide individual loans and housing loans. Interest rates range between 0.8 – 2% per month, calculated on a flat or declining balance. The overall average loan size reported is VND 1.5 million (US\$ 95). Many of the schemes offer financial services as part of an integrated package of other activities⁷⁰. The same is true to some extent for the agricultural production cooperatives that also provide loans in-kind (rice) to members.

The supply of *savings products* in Vietnam is equally standardized but widely available. Access to savings services may thus be hampered more by the lack of trust among customers in large and impersonal institutions than by the actual availability of products or access to institutions. The SOCBs offer a surprisingly limited range of savings products, with an absolute minimum balance of VND 50,000 (\$3), but often VND 100,000 is required. A savings book is issued for each account opened, which can be used as (partial) collateral against a loan, e.g. at VBARD. Campaigns and drives to open savings accounts for children have been quite successful, but the big market players have still to offer the very short-term (liquid) and low-threshold savings accounts globally popular among BOP households. This is perhaps an indication of their limited interest in the BOP market segment in general or a reflection of limited product innovation, although it is true that the very liquid savigs discourage banks from issuing medium- to long-term loans.

Table 5.10 Overview of savings services in Vietnam

	SOCBs	JSCBs	PCFs	VBSP	MFWG
Current/checking accounts					
Min. balance	100,000	100,000			-
Interest rate p.a.	2.4%	3-3.6%	3.6%	2.4%	
Savings accounts (some with check or savings book)					
Min. balance	100,000	100,000			
Interest rate p.a.	2.4%	3-3.6%	3.6%	6-7.2%	2.4-6%
Term (time/fixed) deposits					
Min. balance	100,000	100,000			-
Interest rates p.a.	2.4-9.36%	7-9.24%	3.6-11.2%	7.56-8.16%	
Compulsory savings (loan guarantee)	-	-			
Min. deposit/month (VND)				12,000	12,000
Interest rates p.a.			9.72%	2.4%	2.4-6%

⁶⁹ ADB: Rural Credit Project Performance Evaluation Report, November 2005.

⁷⁰ Viet Nam Microfinance Bulletin March 2006 and "Draft Final Report: Preparing the Framework for Microfinance Development", ADB and SBV, Sept. 2004.

The interest earned on liquid deposits is generally low, and negative in real terms if inflation is taken into account, but the JSCBs are evidently happier to compete with the SOCBs on deposit than on lending rates. In general, however, SOCB savings accounts carry no or fewer transaction fees. VBSP mobilizes limited voluntary savings giving 2.4-8.16% interest p.a. according to its website (highest for term (fixed) deposits). Any large increase in savings mobilization would increase contingent fiscal liabilities given the on-lending interest rate level. The result is that VBSP does not in fact promote savings mobilization to any large extent.

About a third of the INGO-programs offer savings services at interests ranging from 2.4-6% p.a. Most MFPs and MOs as 'agents' for VBSP and VBARD require compulsory savings as a partial guarantee for the otherwise uncollateralized loans, and about one third of MFPs intermediate these savings in the form of loans. As loans outstanding normally exceed the compulsory deposits kept, however, the risk associated with this practice is low.

Most of the approximately 30% of credit-led MFPs that accept voluntary savings from their members also intermediate these funds. While the systemic risk stemming from this practice is limited, there is nevertheless always a risk of liquidity crisis, should the MFP experience a 'run' on its savings. Prudent management of deposits will be a requirement for the MFPs that transform under Decree 28, but for the smaller MFP schemes, it is an area which would merit 'self-regulatory attention' among MFWG members. Although this possibility is not foreseen under Decree 28, there would be a need to develop a Code of Conduct, with the involvement of SBV, which recognizes the MFPs responsibility in safeguarding clients' deposits against moral hazard and related risks, and sets an acceptable Deposit Reserve ratio (current assets/deposits).

In terms of *other financial services* the SOCBs, JSCBs and foreign banks offer the entire range of financial products, including Letters of Credit, forex, money transfers and debit cards etc. Western Union and Money Gram provide cash transfers (remittances), often in agency relationships with banks and non-bank financial institutions, e.g. the post offices, and access is thus relatively easy. The cost of cash transfers in the market do not vary significantly. Some providers offer free transfers between accounts in the same banks or between branches of the same bank in the same province, but most of the formal financial institutions charge 0.02 - 0.07% of the transfer value as transaction fee. Surprisingly, one of the 9 leasing companies and VBSP also report to be offering money transfer services for customers – the leasing company doing so competitively at 0.02%.

The 9 *leasing* companies in Vietnam do not at present cater to the low-end market segment (the average value per lease is over \$ 90,000), but offer leasing finance for urban-based SMEs, primarily within transport and services. Internationally, micro-leasing has proven a popular product for poorer farmers and non-farm households enterprises, and a pilot project was commenced in 2001 supported by IFC-MPDF, under which Vietnam International Leasing Company was provided a credit line from Dutch FMO to provide individual leases under US\$ 10,000 for equipment and vehicles for (M)SMEs⁷¹.

⁷¹ World Bank: SME Facts Vol 2, 1/2001.

The Vietnamese *insurance* sector has been growing rapidly in the past years and there is evidence of growing diversification. Most life insurers target the middle-income market, the minimum premium being VND 84,000 per month (2004). As that market segment is still very under-served, there is currently little incentive, especially for life insurers, to down-scale. Moreover, the life insurance industry is still relatively unknown and there are cultural sensitivities about discussing death. Thus, selling insurance products has been very much a push rather than pull business, and currently, less than 10% of the population has some form of life insurance coverage. Traditional products with underlying guarantees, such as participating and nonparticipating endowment, education and whole life products (combinations of term life and savings), together with a range of term insurance and risk riders (secondary products), are still the mainstream products in Vietnam⁷².

The adoption and continual use of microinsurance financial products, even when they are well-designed, is often lower than desirable because potential and existing policy holders generally do not understand formal insurance⁷³. In the Vietnamese market, another challenge is that many people still prefer placing savings in more traditional and familiar assets such as real estate and bank deposits, which give a relatively high average interest rate of 8.5% on 12-months fixed deposits.

However, a few of the insurers are beginning to offer products that could be appropriate for the low-income market:

- Bao Viet Life offers a life insurance product that requires an annual (minimum) premium of only VND 2,800. At this premium, a subscriber will receive up to VND 1 million in case of death in the family;
- Bao Viet has also launched a voluntary pension insurance scheme;
- Prudential has launched an insurance product for women and for children under 18;
- AIA (US) and the JSCB Southern Bank have recently signed an agency agreement through which AIA will make available a Credit Life insurance product to the borrowers of the bank.

The rapidly developing non-life insurance market in Vietnam has seen several new and encouraging products and services being introduced by formal insurance providers and complemented by semi-formal schemes over the past years, including property, liability and accident/health insurances that are relevant to BOP:

Property (asset) insurance:

- Back in 1982, Bao Viet launched a pilot Livestock Insurance Scheme in three provinces, using the remaining agricultural cooperatives from the former cooperative system as agencies for its contracts. Through the support of the local officials of these cooperatives, farmers were advised of the advantages of livestock insurance, and the cooperatives supported Bao Viet by collecting the insurance premiums from the farmers, which have kept transaction and marketing costs low⁷⁴;

⁷² Mark V.T. Saunders and Adrian Liu, op.cit.

⁷³ Monique Cohen: Using Microinsurance and Financial Education to Protect and Accumulate Assets, Brookings/Ford Workshop on Asset-based Approaches June 26-27th, 2006.

⁷⁴ Thomas Duffhues, Ute Lemke and Isabel Fisher: New ways for rural finance? Livestock insurance schemes in Vietnam, Berlin Conference, October 5-7, 2004.

- Groupama provides livestock insurance in Can Tho, but has faced significant difficulties with the profitability of the product and is trying to diversify its activities beyond agricultural insurance;
- Bao Viet tried rice crop insurance in the past and was not very successful, but it still offers industrial crop insurance (for cashew nuts and coffee, for example);
- GRET in Vinh Phuc has developed a livestock insurance scheme for pig farmers, insuring porkers and sows against 4 common deceases and providing free veterinary advise against a small premium.

Health insurance

- Bao Viet offers a limited personal accident and health care insurance at a minimum premium of VND 2,800/person/year (2004); In addition, Bao Viet's range of products include:
 - Children's comprehensive insurance;
 - Personal accident insurance;
 - Hospitalization and surgical allowance insurance; and
 - Comprehensive personal accident insurance.

Experimental (semi-formal) microinsurance

- The Mutual Aid Fund of the Association of the Elderly has piloted a product combining insurance pay-outs in case of death, sickness and longevity (to 70 and 90 years) in Nghe An, Nam Dinh province, which is currently being expanded to other provinces. The subscription fee is VND 10,000 – 70,000 with an annual premium of VND 1,000 – 5,000 (2004);
- Also on Nghe An, a Farmer's Insurance Fund has been established to pay-out 'pensions' at old-age or death against a monthly premium of VND 20,000;
- A combined 'Credit Life' insurance scheme for clients of TYM, where a premium of VND 200 is paid weekly (or 0.9% of initial loan amount) during the loan cycle, against which pay-outs are made to off-set any outstanding loan amount and provide financial support at the death of the borrower (VND 500,000); or at the death of a spouse/child or severe illness of a borrower (VND 200,000). With the impending transformation under Decree 28, TYM will not be legally licensed to offer insurance, and is thus considering to negotiate a similar product with Bao Viet;
- As part of Action Aid's microfinance schemes run in collaboration with the Women's Union in Son La, Quang Ninh and Ha Tinh provinces, Mutual Aid Funds were established to provide financial support in case of death (VND 200,000) and illness (up to a maximum of VND 40,000/year) against an initial premium of VND 500 payable twice per month⁷⁵.
- An agency linkage product between Bao Viet and the MFP Ninh Phuoc implemented by the VWU in Ninh Thuan province.

With support from AFD and in collaboration with MOLISA, the ILO is assisting in the refinement and piloting of micro-insurance products in rural Vietnam under the inter-regional project "Extension of microfinance and microinsurance to informal women workers". When Decree 28

⁷⁵ ILO: Risk Management Financial Services available in Vietnam, <http://www.microfinance.org.vn/office.htm>

enters into force, however, the licensed MFIs can no longer provide microinsurance services on their own, but they may remain or become agents of regulated insurance companies. As such, it may be pertinent for the experimenting MFPs to link their schemes to regulated providers, as the ILO project is advocating.

c) Performance of Microfinance Providers

To evaluate the performance of MFPs, it is necessary as a minimum to review standardized measures of portfolio quality, efficiency and profitability. In order to assess the performance of the key players in the Vietnamese microfinance industry, the Verification Survey conducted of 130 financial institutions in Vietnam during the Assignment (see details in Annex 3) included questions related to financial and social performance and asked suppliers to provide both the indicators used and the ratios, as of end 2005. In the following sections, the reported results from the 68 questionnaires received have been summarized and where relevant compared to benchmark results for the Asian microfinance industry which reports to the global microfinance database The Microfinance Exchange (MIX).

(a) Portfolio (Asset) Quality

The most widely recognized measure for asset quality in microfinance is the Portfolio at Risk ratio (PaR). The use and reliability of asset quality measurements in the Vietnamese industry, however, vary significantly across providers. SBV favors a ratio of 'overdue' to total loans of less than 3% for commercial banks, but there is no uniform rule applied. Among a series of new regulations passed in 2005, SBV strengthened the liquidity requirements (value of cash and other short-term liquid assets over short-term liabilities falling due) to be at 25% for assets and liabilities with maturities of up to 1 month, and 100% for maturities of up to 1 week. The maximum amount of short-term liabilities (deposits and borrowing with a maturity of less than 12 months) that may be used to fund medium- and long-term loans is set at 30% for SOCBs compared with 40% for other commercial banks, 25% for other state-owned credit institutions (CCF), and 30% for other non state-owned credit institutions (e.g. PCFs and eventually MFIs under Decree 28). SBV also limits the proportion of medium- and long-term loans to 45% of the total loan portfolio.

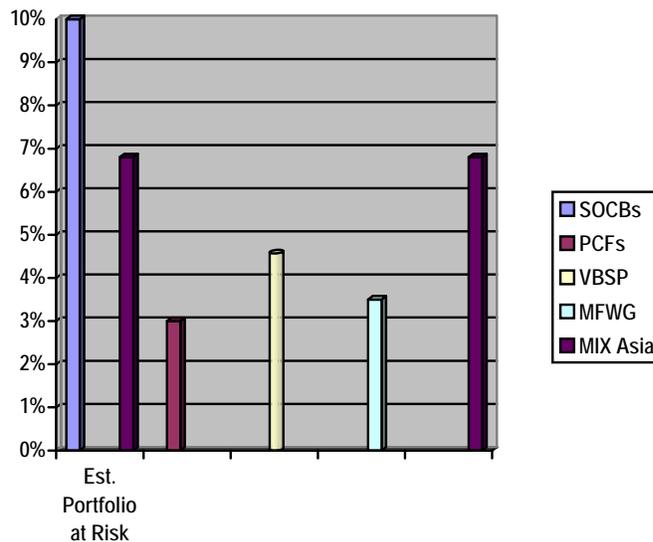
As both VBSP and VBARD practice loan restructuring and do not include all restructured loans or frozen accounts in their reporting of portfolio quality⁷⁶, their figures against these benchmark are unreliable, not least due to the differences between the International and Vietnamese Accounting Standards (IAS and VAS), which have led to significant over-valuation of portfolios in the past, as the VAS loan provisioning requirements (LLR) are well below IAS. For the SOCBs, the LLR as a percentage of the gross portfolio has improved since 2002, and large write-offs of old non-performing loans (NPL) have significantly lowered the arrears rate to around 2.6% (2005). In general terms the repayment rates within the group of semi-formal providers appear to be excellent (97-99%). Portfolio at Risk (30 days) is reported in the verification survey as slightly higher among the formal MFIs: up to 3% for PCFs; 4.57% for VBSP (2005); and 10% for VBARD, although the

⁷⁶ World Bank (2003), *Viet Nam Development Report 2004*, Report No. 27130-VN quoted in ILO Working Paper Series no. 5: Towards a Viable Microfinance Sector in Viet Nam, Issues and Challenges, ILO, 2005.

figures, as indicated earlier, are of doubtful quality (VBSP for instance has never had its accounts audited). Several of the agricultural production cooperatives report arrears rates of up to 15% and one of the leasing companies reports an alarming PaR of 20%.

Against the mean value for the peer group of Vietnam’s MFPs, i.e. the group of 22 small, intermediating MFPs reporting to the global MIX database⁷⁷, the reported PaR ratios in the verification survey for these MFPs do not seem to be cause for concern as they are well within the benchmark for the peer group (2004) of 5% - for now. However, once again, the figures do not come from audited statements.

For (micro)-finance providers, the chief constraint associated with un-coordinated outreach and the absence of a credit reference system (CRS) or strong customer rating systems is the potential but so far un-quantified risk to the portfolio of each provider that un-assessed multiple borrowing presents. If the market is indeed ‘over-heating’ in some areas, as the evidence suggests, and a significant number of multiple borrowers over-indebt themselves, even a small shock to the local economy can cause the portfolios of



all providers involved to be severely affected. The smaller and less risk-provisioning MFPs would be even harder hit. While the industry waits for a CRS or MFIs develop strong internal customer rating systems, higher provisioning ratios and informal sharing at least of information on

defaulting clients may be prudent steps to take.

Figure 5.11 Comparison of PaR levels

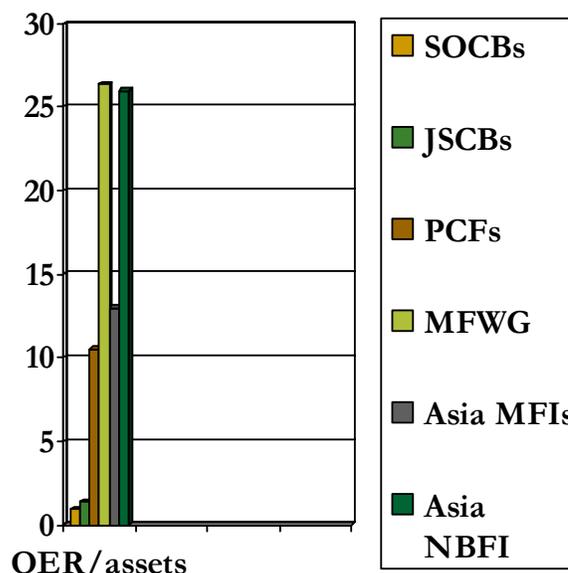
(b) Efficiency and Productivity

⁷⁷ See www.themix.org

Information and data related to financial efficiency of MFPs in Vietnam is scarce and its reliability is questionable. However, the questionnaires provided some useful analytic data.

The SOCBs report a very low Operational Expense Ratio (OER) over assets of 0.75-1.16%, while VBSP reports no efficiency indicators at all. Only one third of the respondent PCFs in the survey report to be tracking efficiency, and their OER was in the range of 9.3-11.8% - only slightly higher than the leasing companies at 8.9 – 9.9%, but significantly higher than CCF at 2.9% (2004). Among the semi-formal MFPs, only the largest and most intensively INGO- or donor supported projects are able and encouraged to track, record and report any efficiency ratios at all, but for the 5-6 that do report, the OER is in the range of 16.2 – 39.8%, high when compared to the formal institutions, but relatively low in relation to the regional peer group average of 49.8% (2004), reflecting both the low labor costs in Vietnam and the hitherto limited financial costs.

Figure 5.12: Comparison of OER levels



Recognizing the capacity gap, the questionnaire distributed by the MFWG for MFPs to report on performance does not include efficiency ratios. It does, however, include the front line (credit officer) productivity ratio, which reflects how productively an MFP uses its human resources, i.e. its personnel. This ratio uniquely defines microfinance providers, as they must be able to handle large number of customers with a minimum of administrative effort. The higher the ratio, the more productive the MFP (adjusted for MFPs that provide group loans). The 42 MFPs reporting efficiency data to the MFWG had a high average productivity ratio of 131, compared to the regional mean of 121 borrowers/loan officer for the peer group of Vietnamese MFPs, i.e. small deposit-intermediating MFIs in Asia. When compared to the mean for non-financially intermediating MFIs in Asia of 254, however, the result for MFWG members is low, and also hides a huge variation among MFPs. 33% of reporting MFPs have a front line staff productivity ratio of less than 50; and additional 28% report less than 100 clients per loan officer. The ratio may indicate that the staff of the MFPs are tied up in excessive paperwork and procedures – or, as local employees of Mass Organizations, that they are charged with multiple other tasks and cannot fully concentrate on serving clients and not necessarily low productivity per se.

(c) Profitability and Financial Sustainability

Reliable profitability data is extremely hard to come by in Vietnam. The SOCBs responding to the Verification survey (see Annex 6) report a range of 0.35 – 1% Return of Assets (RoA). At a net interest margin of 0.57 – 5.95%, the SOCBs report a portfolio yield of 7.3 – 8.56%. Several SOCBs report Operational Self-Sufficient ratios (OSS), which is unusual for banks, but only at 116-120%, which would indicate a very slim profit margin indeed, assuming that at least a part of their borrowing is on commercial terms, which will lower their financial self-sufficiency (FSS) ratio well below OSS.

The under-provisioning for loan losses under VAS led to a significant overestimation of net income for VBARD during 2002-2004. The more liberal treatment of bad and at-risk loans under VAS and the resulting overstatement of profits in recent years have led to a significant overestimation of the value of VBARD's loan portfolio and capital. Under IAS, the net loss decreased as profitability improved during the past few years, but VBARD remained 'in the red' at the end of 2004. As a consequence, VBARD's Return on Assets (RoA) has been negative but improving since 2001, at -1.8% (2002) and -0.37% (2004) and it turned positive at end 2005 at a reported 1.35%. This improvement in earnings is also reflected in VBARD's operational sustainability, which rose from 81% (2001) to 93% (2004) based on financial income alone or 99% based on total income. Financial income (interest, fees, commissions, etc.) has also been increasing as a proportion of total income and reached 94% in 2004. However, VBARD's interest spread declined until 2004 due to the rapid increase of interest expense. Interest income as a percentage of the average loan portfolio increased from 9.96% in 2001 to 10.17% in 2003 and only marginally in 2004 to 10.18%. By contrast, interest expenses as a percentage of average deposits and borrowing increased over the same period by an average of over 7% per year, from 3.80% in 2001 to 5.04% in 2004. This has resulted in a declining interest spread from 6.16% in 2001 to 5.14% in 2004⁷⁸. In 2005, VBARD reported a large jump in interest spread to 8.9% which may be explained by the general increase in interest rates to about 1.3% per month. The increase is striking since by the end of 2005, the average spread for the SOCBs responding to the Verification survey was only 4.7%.

JSCBs serving SMEs charge slightly higher interest rates than SOCBs at a range of 9 – 15.6% but respondent JSCBs in the Verification survey report an average interest spread of only 4.06% and RoAs of 0.77- 3.28%, with ACB and Sacombank at just below 2%. At a net interest margin similar to the SOCBs of 1.5 – 6%, it is interesting that the portfolio yield of the JSCBs is significantly higher at 10.9 – 15.8%, probably due to higher efficiencies and lower costs. One JSCB reports OSS at 133% and one Financial Self-Sufficiency ratio (FSS) at 123.8%. As a group and under VAS standards, the JSCBs appear to be profitable.

Only 18 of the PCFs that report financial data to the SBV (March 2006) could produce a profit higher than VND 1 billion (US\$ 62,500). Of the 25 PCFs responding to the survey, 10 reported profitability indicators. PCFs are by nature more demand-driven than credit-led MFPs which appears to be reflected in their interest rate range of 8.4 – 17.4%. Several

⁷⁸ ADB: Rural Credit Project Performance Evaluation report, Nov 2005 and response to survey from VBARD.

PCFs do provide concessional rates for loans to poor households if they are eligible. The reported interest margin in the Verification survey is low at between 0.72 – 2.62% considering their lending rates and may reflect poor calculation skills; comparatively, the seven PCFs that receive intensive technical assistance from DID average a much higher margin of around 43%. Even at the reported interest margin, however, the PCFs report an OSS ranging from 110-125%, resulting in an FSS around or just below 100% including the financial costs that the commercially borrowing PCFs are incurring.

In terms of financial performance, the chief constraint for regulated – and to some extent un-regulated - providers has been the limited profit margins allowable in the Vietnamese financial market. The gradual deregulation of the GoV interest rate regime has not yet led to major movements in the formal market rates charged for loans whereas the elasticity on deposit rates has increased. Rapid growth in monetization, reluctance to compete on interest rates, and occasional indirect SBV intervention are all possible explanatory factors.

The largest providers (SOCBs) appear to be the key source of the constraint, as most other banks seem to follow the lending rates set by them. This may be a serious challenge for the financial sector in the longer run with repercussions also for microfinance. As noted by the WB (see text box), a continuation of this practice will limit and constrain the development of sound microfinance operations, as these will require even higher interest rates to cover their real costs. The 5 SOCBs responding to the Verification survey in August 2006 reported lending rates in the range of 8.5 – 13.5% p.a, which for their primary market segment of corporate may be sufficient to cover costs, even if that remains a concern, especially for VBARD⁷⁹.

WB Banking Sector Review (para 144):
"SOCBs explain this inelasticity [of interest rates] as a fear of competition and a perceived duty to advance their clients' business prospects through providing good rates. This could imply quite an unusual type of pricing by the large SOCBs maintaining the lending rates at concessional levels despite their own interest margins possibly being insufficient to cover both their cost, credit risk and asset growth. In the short term, this inelasticity may appear to be beneficial to the SOCBs and borrowers, in the medium- to longer-term this could hurt the viability of the JSBs and potentially harm the development of a market-oriented and competitive financial sector. It is conceivable that the banks may today be pricing only to cover the direct cost of operations, with no allowance for true cost of capital, provisioning for credit risk or for building capital base for future growth."

The semi-formal MFPs incur the highest lending costs because of the target group they serve and their operational structure. They should therefore have the highest lending rates to remain profitable or at least not incur losses. And indeed, the largest and most professional semi-formal MFPs apply lending rates ranging between 12 – 24% p.a. The average for poverty loans is 14.6%. However, many of the smaller MFPs charge rates ranging from 9.6-12% which are similar to the rates charged by SOCBs. These rates are insufficient to attain sustainability.

Of the 44 MFPs reporting to the MFWG, 70% self-reported *operational* self-sufficiency ratios higher than 100% As of March 2006 (FSS is not reported). Given the lack of standardization

⁷⁹ See WB: Rural Finance Project Appraisal, 2002.

in the calculations, the limited financial costs (very little borrowed capital) and the generally low technical capacity, it is, however, questionable whether much more than a handful of these MFPs would attain actual financial self-sufficiency (profitability).

Table 5.13 Key profitability indicators of selected MFPs respondents to the Verification survey

Type of MFP	Lending rate	Deposit rate	Interest margin	RoA	OSS	FSS
SOCBs (VBARD)	8.5-13.5%	2.4-9.36%	0.57-5.95%	0.35-1%	116-120%	Est. 98%
VBSP	7.8 – 9.6%	2.4-8.16%	-	-	-	-
PCFs	8.4 – 17.4%	3.6-11.2%	0.72-2.62%	0.66 – 2.16%	110-125%	Est. 95%
MFWG members	9.6 – 24%	2.4 – 6%	17-23.4%	4-5.29%	42-166%	25-110%

Competition is still limited in most areas of Vietnam and most multiple borrowers appear to accept the differing interest rates and select providers based not only on interest rates but also on other aspects of the service. By and large, semi-formal MFPs appear able— when it is necessary – to charge higher rates of interest, thus covering a larger share of their costs. Particularly, the largest MFPs, those poised for transformation, have increased their lending rates and as a consequence are able to report average interest margins of 17-23.4% As of end 2005, bringing their OSS ratios up around 120-166%. However, even these MFPs remain only just on the verge of financial self-sufficiency (FSS) at 85-110% without incurring major financial costs. The majority of the smaller MFPs have much lower profitability ratios.

To attain financial sustainability, MFPs will need to grow their scale of operation. For this, they need to access capital to lend out, either through shares or deposit mobilization as the SOCBs and PCFs; or by borrowing or receiving grant capital as the VBSP and the semi-formal MFPs. However, none of the semi-formal MFPs in Vietnam are able currently to access commercial capital, and the amount of grant capital from their INGO funders is limited. For VBSP, the mandated lending rate cap makes savings mobilization unfeasible. Thus, access to capital is a key constraint to the potential growth for these providers. Decree 28 will provide legal status to the semi-formal MFPs which will help them increase access to financial resources. But they will also need to develop a clear business plan documenting their market niche (demand) and providing financial projections; expand their product range and enhance their governance and management capabilities.

d) Financing the Microfinance Providers

The Government of Vietnam has contributed capital to all of the formal financial service providers serving BOP. In addition, the SOCBs and JSCBs have access to ODA credit lines either directly; through specialized units such as the Transaction Center III of BIDV which functions entirely as an intermediary of ODA credit; or through donor-funded projects (e.g. SMEPF). Policy lenders (VBSP and VDB) access ODA credit and so does CCF, the apex institution which on-lends to the PCFs.

The key rationale for external credit infusion into the formal banking system is the lack of long-term credit financing, and/or the desire to provide incentives for the formal financial system to extend credit to new and under-served market segments (there is no “liquidity” shortage as such in Vietnam). The targeted credit lines for the rural and/or poor market

segments provided by ADB, World Bank and AFD via MOF and BIDV and by KfW via MOLISA and directly to VBARD all require the borrowing institution to serve a low-income market segment. By contrast, the competitively awarded EU credit provided through the SMEDF located at the VDB while providing targeted, subsidized credit largely to SOEs, appears to apply a more demand-driven approach based on applicants' business plans for entering the SME market (see Annex 5 for a list of credit lines available from the major multilaterals and bilaterals)

The international donors have allocated significant amounts of credit to the banking sector for on-lending to SMEs and individuals. However, it is questionable whether the TA provided to complement the credit lines has been successful enough to entice the recipient banks to take over and continue the lending to SMEs using their own resources. Moreover, there does not seem to be any clear exit strategies among the larger donors concerning the future provision of credit lines and in many cases few demands on the recipient banks to allocate own funds and share the risk of investments.

The INGOs supporting the semi-formal MFPs provide grant-based funds for loan capital, but rarely in sufficient amounts for the MFPs to grow their portfolio to scale. None of the MFPs in Vietnam have succeeded in accessing commercial or ODA credit yet both because their financial performance in general is weak, and because they lack legal status until Decree 28 comes into effect.

The Microfinance Loan Fund (MLF) under the 2nd Rural Finance Project of the World Bank instituted in 2002 allocated US\$ 28 million for lending to Microfinance Institutions (MFIs) including commercial and Joint Stock banks, credit cooperatives, PCFs and credit-granting NGOs accredited by the BIDV as the implementing agency. However, to date 95% of the credit funds allocated through the otherwise well-designed MLF has been channeled through VBARD, and so far, no PCF nor any semi-formal MFP has been accredited for access to loan capital or the institutional strengthening envisaged under the program.

The eligibility criteria for MFIs include a 'capital build-up program' to reach the 12% of risk assets (portfolio) generally required; net equity of 10% of risk assets; a liquidity ratio of a minimum of 30% and audited accounts⁸⁰ – most of the current semi-formal MFPs would be unable to meet these criteria. Recently, the TYM fund was rejected as an applicant for the WB credit line administered by BIDV due to its semi-formal legal status and its accounting system not complying with current Vietnamese accounting laws. Whereas the first reason demonstrates the need for Decree 28 to provide an accepted legal form for MFIs, the second reason is regrettable, as the accounting system maintained by TYM follows international good practices for MFIs (CGAP), which are more transparent, if admittedly different from standard provisions for banks in Vietnam.

⁸⁰ World Bank: Rural Finance Project Appraisal, May 2002

6. *Support Structures for Microfinance*

Successful microfinance providers maintain a social mission by targeting the low-income segment of the market while providing their services using sound business approaches – the so-called ‘double bottom line’. Like other businesses, MFPs need a range of business support services, e.g. audits, ratings, credit reference services, cash-in-transit services, insurance and guarantees, IT support, training, consultancies and capital.

A) *Technical Assistance Services*

Technical assistance and capacity building are among the supporting services required by microfinance that need to be strengthened in Vietnam. Technical assistance to the financial and banking sector has primarily been provided through externally funded programs and institutions. It is only recently that the private BDS sector in Vietnam is building up capacity to serve the financial institutions.

Many banks run their own in-house training programs for their staff. Complementing these efforts, the main external training resource for the **formal financial institutions** in Vietnam is the private Banking Training Centre (BTC) established in 2001 with support from the Financial Markets Development Program of the IFC-funded Mekong Project Development Facility (MPDF). The BTC has 24 trainers that are specialized in bank training and has trained over 8,000 local bankers through some 300 workshops in core banking, management and organizational skills. In 2006, the BTC course program includes training on Lending to SMEs and Households; Consumer Lending; and Credit Portfolio Management. The BTC also offers specific on-site consultancies to banks, and is currently implementing a 3-year TA-program for local private sector banks by the Swiss State Secretariat for Economic Affairs (Seco).

In addition to specialized marketing and management training for SMEs in the tourism, garment and agribusiness industries, the IFC-MPDF has also developed a suite of affordable (partially subsidized), locally tailored management training resources (the ‘Business Edge Management Training Program’) and is currently facilitating the access by middle-managers in Vietnam to internationally recognized certificates of applied business skills. The IFC-MPDF is also providing TA to the SBV for the establishment and sourcing of a private sector credit reference bureau.

Most of the formal banking institutions in Vietnam receive capacity building assistance (training and technical assistance) through programs financed fully or in part by the bilateral and multilateral agencies. These include:

- BIDV and the retail banks that on-lend funds from the World Bank-financed Rural Finance Project II receive TA in a variety of banking subjects financed under the project. The WB has also provided technical assistance on commercial bank reporting through a New Zealand trust fund and on the supervision of banks using a CAMELS-based ratings system at the SBV through an Irish trust fund;

- TA and training to the SBV and the banking sector reform process, including SOCBs and the policy lender VBSP; as well as to MOLISA and Vietnam's Academy of Finance (for training of trainers in corporate governance) and Academy of Social Sciences (for the establishment of a pro-poor policy research unit)⁸¹. These programs are financed under the multi-donor funded Asian Financial Crisis Response Trust Fund of the Asia-Europe Meeting (*ASEM TF2*) managed by the World Bank and effective since April 2001. Under this facility, Vietnam has received grants of US\$ 9.2 million of which US\$ 5.8 million have been earmarked for capacity building
- The training program offered to VDB and retail banks that on lend from the *EU* revolving financing facility for Medium- and Long-term lending to SMEs (SMEDF) is managed by the BTC, and partially subsidized by the SMEDF program. In 2006, the courses offered include Appraisal of SME business Plans, Evaluation of SME Term loan applications, and Management of a MLT loan portfolio;
- TA provided to the JSCBs where *IFC* supported by Swiss, Japanese and Dutch are currently investing, i.e. ACB and Sacombank, and for the equitization of the Mekong Delta Housing Bank which is also receiving TA through the Seco-facility implemented by BTC;
- TA and training to JSCBs financed by *USAID's* VNCI project to facilitate access to finance for SMEs;
- TA support to the SBV provided by *CIDA* and through DID performance assessments and training to the CCF/PCF network. The program is currently piloting adjustments and development of the PCF model through intensive modernization of seven selected PCFs;
- TA support to SBV and the PCF network by *GtZ* focusing on internal and external audits and supervision;
- Training and institutional capacity building to VWU provided by the *DGIC* (Belgium) as part of the implementation of the VBCP;

In the **microfinance sector**, training, TA and institutional development has been provided primarily by ILO and lead INGOs engaged in the sector. Some training and TA has also been provided directly to local counterparts (usually MOs) of multilateral and bilateral projects. Very few national consultancy companies seem to have specialized in microfinance, and the few national consultants available are thus used by almost all providers (and donors), to the extent that external TA is solicited at all.

The Microfinance Resource Center at the Ha Noi National Economics University, which was originally supported by CGAP as a training hub, was renamed in 2003 to the Resource Center for Banking and Finance, and now focuses more on formal banking. To continue the building of national training capacity, the multi-donor funded Vietnam Development Information Center (VDIC) is hosting the CGAP-sponsored distance-learning course in microfinance aimed at training and certifying national trainers and consultants. Participants who complete all modules receive a certificate jointly issued by Asian Development Bank Institute (ADBI), the Tokyo Development Learning Center (TDLC),

⁸¹ Asia Europe Meeting (ASEM) Asia Financial Crisis Response Trust Fund Review of Progress and Country Strategy Notes, April 2006.

the Global Development Learning Network in East Asia and the Pacific, and the VDIC. In addition, the Mekong Economics and The Center for Rural Progress in Ha Noi have been used by some providers.

Most of the international auditing and management consultancy firms are represented in Viet Nam, and they are to a certain degree involved in the sector; PWC has been contracted to draft a manual for internal audit in the VBCP, while KPMG has offered financial management training to MFPs and VBSP and has been contracted for program audits.

As part of the framework contracts, VBARD has provided some training to clients and Women's Union staff in basic financial and banking skills.

Under the World Bank 2nd Rural Finance Project (2002-08), US\$ 2.6 million was allocated for institutional capacity building support for accredited microfinance providers. For MFPs not immediately meeting the prudent eligibility criteria for accreditation, it was foreseen that BIDV and WB could approve access to these funds by submitting an Institutional Development Plan (IDP) including a training plan focused on improving solvency and liquidity; increasing profitability and sustainability, improving loan portfolio quality, increasing resources mobilization, particularly, medium and long term savings; and improving the capacity of its management and staff⁸².

While the CCF and the JSCBs and SOCBs wishing to down-scale, could probably meet the requirements and/or submit an acceptable IDP, this has not to date been possible for credit-granting NGOs (semi-formal MFPs), and thus none of the semi-formal MFPs that have received much less training and TA support and arguably need the capacity building most have been able to access this facility.

B) Advocacy and Coordination in the Microfinance Industry

VINASME (Vietnam Association of SMEs) was established as a dialogue and advocacy platform for the rapidly growing SME sector, now numbering approximately 128,000 registered companies employing 10-300 staff, of which perhaps 80,000 are operational. VINASME offers training to members, and recently organized an innovative Banking, Finance and Insurance Exhibition (BFI Expo) in HCMC⁸³. At the event, banks and financial institutions, including VBARD, BIDV, JSCBs and Bao Viet introduced their products and services and described their requirements and technologies, and SMEs had the opportunity to demonstrate feasibility of investment proposals and payment capacity of their companies.

Based on the priority need for employment creation and given that SMEs comprise some 96% of all companies in Vietnam employing 26% of the work force, the Ministry of Planning and Investment (MPI) established the Agency for Small and Medium Enterprise Development (ASMED) to spearhead the process of developing an SME Development Plan and Action Plan

⁸² World Bank: Second Rural Finance Project Loan to Vietnam, Project Appraisal Document, May 2002.

⁸³ BFI Expo held in HCMC 27-31 July 2006.

("Road Map") for 2006-2010 as part of Vietnam's SEDP. With input from government, donors, and the private sector, the Road Map is aiming to remove identified constraints and create a more enabling environment for the growth of SMEs, and a number of reforms on the legal and policy framework for SMEs are being proposed including simplification of the business registration process and improvements of the capabilities and competitiveness of SMEs. As part of the process, a Public-Private dialogue system has been established with the Investment and Trade Promotion Centers in Hanoi and HCMC acting as the focal points⁸⁴. It is hoped that the Road Map will create a clear set of objectives allowing increased coordination between various government agencies, donor-funded programs and the private sector. As such, the initiative offers an excellent example of a coordinated process for more enabling policy making for an important segment of the private sector, which could be replicated for the finance sub-sector.

Within the banking sector, *The Vietnam Banks Association (VNBA)* was established as an autonomous professional organization under the cumbersome Law for Associations in 1994 (revised latest in 2003), and currently has 45 members: the 5 SOCBs, the 37 JSCBs, the 6 finance companies and DIV. It is hoped that foreign and JV Banks will join in future, as the restrictions on their voting rights in the Decree and Statute of the VNBA are being lifted. It is governed by a General Assembly, which elects a management council and an executive office located in Ha Noi and headed by the Secretary General. It is financed entirely by members that currently contribute a 6/100,000th of total assets in annual membership fees.

VNBA acts as a national industry representative and provides information to members on developments within the banking sector, and is recognized as an industry stakeholder by GoV; the association participates in the drafting and revision of legislation and regulations, comments on licensing and regulations, and conducts research within the sector to feed into the policy dialogue. It arranges workshops and meetings on new legislation, regulations and policy developments in the banking sector for members and non-members, and publishes an annual report on issues and constraints in the sector. While the VNBA has not detected any strong interest from members in microfinance, management appears open to invite MFIs licensed under Decree 28 to workshops to enhance information flow and coordination within the financial system.

In the microfinance sector, the informal *Microfinance Working Group (MFWG)* plays an important coordinating role. During the drafting of Decree 28 by the SBV with assistance from ADB, the semi-formal microfinance providers in Viet Nam had little access to the process and were not generally very informed or involved. To discuss the first draft of the Decree in May 2003, CEP and SCUS organized a national microfinance conference, which provided the impetus for the revival of the informal MFWG in April 2004 and key INGOs formed a small management team ('core group') of volunteer practitioners, led in the initial stages by PLAN International, and currently by WVI and SCUS. While not formally chartered, the MFWG found a legal 'home' under the framework of the Viet Nam Union of Friendship Organizations (VUFO) NGO Resource Center.

⁸⁴ Vietnam Chamber of Commerce and Industry: Business Issues Bulletin, No. 8, June 2005.

As all informal networks, the MFWG has largely subsisted on the commitment of individuals. This commitment has evidently been high among INGO staff exposed to microfinance good practices and centrally placed in Ha Noi. National NGOs/MOs appear much less engaged in the process and much less convinced of the objectives and benefits of a strong network. This is not surprising in Viet Nam, where the concept of lobbying is not strong and where associations have traditionally been structured like the MOs as large, hierarchical and bureaucratic representatives of a sector or interest. Especially among national NGOs that may not be technically specialized in microfinance, the mandate and legitimacy of the informal network is queried, and the degree to which members represented their organizations is unclear. Annual work plans are developed (during 2005 centered around the analysis of Decree 28 and the requirements for MFPs transformation), but activities have been completed only to the extent that the busy core group members could find time outside of their already full schedule to accomplish them. The MFWG has established an email membership list to disseminate information electronically, but membership is not formalized and the network has no income from membership fees. Instead, INGO projects support specific activities from existing budgets.

MFWG publishes a semi-annual Viet Nam Microfinance Bulletin, first issued in 2002. Every issue includes aggregated data on outreach and performance by an increasing number of microfinance programs (currently 44). The data provides a good overview of the industry but as it is submitted voluntarily it is not independently verified by the MFWG and the data reviewed suggest that ratios and calculations are not standardized among microfinance practitioners in Viet Nam. Despite the significant effort required for the fragmented and relatively immature industry to agree on a set of indicators and train all subscribers to report them systematically and accurately, MFWG continues to aim at establishing consensus performance standards for MFPs.

Since 2004, field visits for SBV and ministry representatives have been organized to different microfinance programs, MFWG meetings have been held to discuss the draft Decree with SBV, and members have been encouraged to send suggested revisions to the SBV. To support the advocacy effort, the MFWG crafted a statement on microfinance for the Consultative Group Meetings in June and December 2004, and IFC funded its publication in the Viet Nam Business Forum magazine. A Statement to promote the early publication of the Circulars under the Decree was submitted to the CG Meeting in 2005.

Because of the current dominance of INGOs in the MFWG and because the legal options for registration of a 'business network' or an association are few and challenging (the formation of an association still requires government approval⁸⁵), it may not be pertinent to invest significant efforts in formalizing the Working Group until more lenient NGO legislation is adopted. As an informal grouping, the MFWG has been recognized as an advocate for the industry, and it would seem pertinent to maintain and develop this function while awaiting the coalescence of more national stakeholders around good-practice microfinance. This objective could in turn be supported directly by a focus on capacity building for the industry at large. Currently, the international support network for national microfinance Associations under SEEP and IFAD with matching-grants from SCUS and Ford Foundation are finalizing a support package to enable

⁸⁵ World Bank: Joint Report to the CG Meeting: Business, 2005.

the MFWG to contract a full-time Coordinator, establish a secretariat and produce a business plan, including a study of options for formalization.

C) Development Partnerships in the Financial Sector

Vietnam receives a significant amount of Official Development Aid (ODA) from 49 bi- and multi-lateral agencies and some 500 international NGOs are active in the country in a variety of sectors and activities. In 2005, the total ODA announced amounted to US\$ 3.74 billion or around 10% of GDP, and a total of US\$ 1.8 billion was disbursed, of which 85% was in concessional loans⁸⁶. Japan is the largest donor (22.29% of total) followed by the World Bank (20%), ADB (14.38%), France (10%)⁸⁷ and Germany.

The Government of Vietnam (GoV) gives significant attention to leading partnerships with other stakeholders, especially with external partners, under the Comprehensive Poverty Reduction and Growth Strategy (CPRGS), Vietnam's medium-term poverty reduction strategy, which serves as its PRSP, and the 5-year Socio-economic Development Plan (SEDP) for 2006 - 2010. Better coordination, increased transparency and higher levels of effectiveness of development assistance are also priority principles driving the global effort for increased Harmonization and Aid Effectiveness. In Vietnam, Consultative Group (CG) meetings have been held semi-annually since 1998, co-chaired by the GoVN and WB. Vietnam participated in the High-Level Forum of Aid Effectiveness in Paris in 2005 and adopted the Paris Declaration. A Vietnamese version of the Paris Declaration was produced in the Hanoi Core Statement which commits GoVN and donors to improving aid effectiveness across the board. It sets down 14 key indicators relating to ownership, alignment, harmonization and simplification, managing for results, and mutual accountability, and establishes indicative targets for 2010. In addition, the Vietnam Harmonization Action Plan (V-HAP), first developed in 2003, has been revised based on the 14 indicators and outputs for the 2010 targets of the Hanoi Core Statement⁸⁸.

To further raise the level of ownership of development assistance by Vietnamese agencies, enhance transparency, and improve financial management and overall development effectiveness, the principles of the Comprehensive Development Framework (CDF) are being implemented in Vietnam through the work of some 20 thematic Government-Donor-NGO Partnership Groups, including the Private Sector Forum/Vietnam Business Forum, the Poverty Working Group in which the core members have formed the Poverty Task Force, the Partnership Group on SME Development, and the group on Financial Sector Development.

The Financial Sector working group (FSWG) was established in late 1999 to discuss and support the implementation of the proposed banking reform program developed by SBV, and to coordinate donor support on banking reform. Since then, the working group has expanded beyond just banking reform and now covers a wide range of financial sector issues, and representatives of the Ministry of Finance (MOF) and State Securities Commission (SSC) are invited to meetings.

⁸⁶ WB: Taking Stock, op.cit, June 2006.

⁸⁷ Ambassade de France: La Cooperation Franco-Vietnamienne, Faits et Chiffres, 2006.

⁸⁸ www.mpi.gov.vn/oda

The FSWG meets quarterly. It is chaired by the SBV and normally attended by 10-15 donor agencies and projects, notably World Bank, ADB, IMF, EU, IFC, GtZ, CIDA, USAID and Seco all of which provide assistance to the sector. The FSWG is by nature informal, and serves as a forum for periodical sharing of information on the financial sector reform program; providing updates on current financial sector developments; coordinating various donor reform activities; and as a platform for GoVN to seek donor assistance. A comprehensive matrix covering support provided by all donors to the financial sector has been developed, and includes support, inter alia to policy lending, microfinance, and non-bank financial institutions.

The Government's CPRGS and the Banking Sector "Roadmap" titled "Development Objectives and solutions for the Vietnam Banking Sector up to 2010 and orientation to 2020" approved in May 2006 enjoys strong backing by the members of the FSWG. The key Government agencies involved in reform implementation, the SBV and SSC, are linking the sector development strategies to their assistance needs and priorities, and there is evidence of good accord between the sections on financial sector reform in the CPRGS and overall donor supported technical and lending assistance.

The FSWG has set qualitative measures for its own success, including regular meetings under GoVN leadership; effective information sharing and project progress reporting through the Financial Sector Assistance Matrix; improved and accelerated implementation of the financial sector reform programs as outlined in the CPRGS and other key Government development strategies; and *increased efficiency of donor assistance to support the financial sector reform agenda through enhanced strategic planning and sequencing of financial sector reforms and assistance initiatives*⁸⁹. The latter task has arguably received the least attention. In the Matrix, a total of 22 reform areas are listed. The projects listed within each area appear to have been guided more by which donor might have had funds available at a given time than by a joint and strategically planned approach based on comparative advantages. However, SBV has developed a TA master plan which will set the stage for TA prioritization, sequencing and planning and an electronic system to manage all FS provided technical assistance.

⁸⁹ World Bank: The CDF and the partnership groups, www.worldbank.org.vn, June 2005.

Table 6.1 Examples of ongoing donor assistance to selected financial reform areas⁹⁰

Reform Area	Donors providing ongoing support	Type and examples of areas of support
Policy level		
SBV restructuring	Japan (JICA), World Bank, IMF, IFC, EU, SECO, ADETEF (Fr), AusAid	TA, training and funds for audit, self-assessment, customer due diligence, capacity building needs, macro-econ. models, international integration etc.
Monetary policy	IMF, JICA, ADB, GtZ, SIDA (SCB)	TA, training, funds, staff exchange for monetary policies, reserve management, debt markets, OMO, TB etc.
Banking Legislation	GtZ, CIDA, USAID, IMF	TA, training, funds to review and draft new and revised Laws, decrees, and decisions.
Bank Regulation and Supervision	GtZ, WB, ADB, IMF, EU	TA, training, funds for capacity building, risk-based supervision, asset classification, ratios, auditing, IAS introduction etc.
Retail level		
SOCB restructuring	AFD, WB, GtZ, UNSAID, IFC, Seco	Loans, credit lines, TA, training and funds for audits, restructuring plans, IT, conversion to IAS, risk and portfolio management etc.
Policy lending	WB, EU	Credit lines, TA for reform and development of VBSP and VDB
SME credit	JBIC, ADB (DFID), KfW, EU, AFD, USAID	Loans, credit lines, guarantees – but little TA for increased access by SMEs to credit
NBFI development, leasing, financial intermediation	ADB, KfW, AFD, GtZ, JICA, UNDP, USAID, IFC	Loans, credit lines, TA and training for leasing (to SMEs), capital markets, corporate bonds, securities
Microfinance	ADB, CIDA (DID), GtZ, AFD, JBIC, KfW, WB, OPEC, IFAD, and DGDC (Belgium)	TA for legislation, regulations (ADB) Loans, credit lines, TA for expanding rural credit through VBARD, PCFs (JBIC, ADB, ADF, KfW, GtZ, DID) Subsidized poverty lending through VBSP (OPEC, IFAD) Capital and TA for MFIs (WB RFP) TA to MFIs (DGDC, German Savings Bank)

As is the case in many countries, “ODA coordination” in Vietnam has tended to focus on the comparatively ‘easy tasks’ of compiling and sharing data in a dialogue with GoVN with the ultimate aim of increasing the ownership and thus leadership by government of the more difficult process of building consensus around good practice funding and aligning donor approaches to become better business partners.

Despite the formal coordination channels, the level of actual coordination, co-operation and coherence in approaches among financial sector donor agencies is relatively low. There seems to be little attention to lessons learned and generally accepted ‘good practices’ for financial sector development in the international aid community, and the task of coordination placed on the shoulders of the over-stretched government seems larger than necessary. For example, at the policy level some 10 donors are supporting SBV in a less than well-coordinated fashion, and the processing of a multitude of well-meant inputs on legislation, regulations and procedures is tasking for the under-resourced government agency. Likewise, 4-5 donor agencies are supporting the main players in BOP finance, i.e. VBARD and CFF, on different terms and conditions and with different requirements. Even within the ‘Five Bank Group’ i.e. WB, ADB,

⁹⁰ Summarized from the Financial Sector Assistance Project Matrix by the FSWG, May 23, 2006.

KfW, JBIC and AFD that provide the majority of credit to Vietnam, the purposes, terms, and impact of the support could be better coordinated.

The EU-funded SMEDF, the ADB-DFID ‘Making Markets Work Better for the Poor’ project which is developing an ‘SME Road Map’, and one of the courses offered by BTC in 2006, are good examples of projects that aim to balance financing to SMEs with technical assistance in appraisal tools to help financial institutions better assess and monitor loans to small businesses and thus improve their long term capacity to operate with less external capital. Similarly, in the microfinance sector, the vast majority of external assistance to date has been provided as capital for on-lending by VBARD and the PCFs which reach only a small part of the poorest segment of the population. The lack of capacity building programs for MFPs to alleviate the recognized weaknesses of many of them and the understandable strict requirements of some of the external projects has meant that apart from VBARD and the PCFs, few MFPs have been able to access external support. Only one donor agency (DGDC) has invested directly in a microfinance program.

It is clearly the responsibility and interest of the government to coordinate aid and achieve a higher level of inter-donor coordination of approaches and agreement. National ownership is important, but donor agencies themselves could do more to align and coordinate approaches and mandates with a view to increase coherence. In the financial sector, FSWG could be an excellent forum for ‘donor-internal’ discussions, clarifications and alignment of approaches and strategies to enable a higher level of coherence in the dialogue with GoVN and implementing agencies, particularly on the development of sustainable financial services markets and in building broad consensus on the principles for financial sector development in Vietnam.

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7. ***Taking Stock: Key Constraints in the Industry***

Enhanced microfinance can contribute to overall economic development in Vietnam through poverty reduction. It contributes to poverty reduction by ensuring access to demanded financial services by the poorest segments of society that are often excluded from conventional banking. But for the full positive effects of microfinance to be felt, Vietnam needs to address a number of institutional, policy and legal constraints.

A) *Institutional Constraints*

a) *Targeting, Demand-drive and Market-orientation*

Targeting the market of the poor does not require exclusivity of focus – but it does require specialized and adapted delivery mechanisms that can serve the poor effectively – solely or as part of a larger portfolio. Appropriate targeting and development of systems, methods and products must thus replace the standardized and to some extent static approach that has characterized the Vietnamese microfinance industry so far.

There are niche markets of very poor people in remote and under-served areas (ethnic minority communities) but the biggest market segment for microfinance in Vietnam are the 24% poor and low-income households that by and large already have access to some financial services. As discussed in chapter 5.1 above, this market will demand increasingly diverse and sophisticated financial services from the providers in the coming years, and successful microfinance providers will be those that adjust products, services and delivery mechanisms to the market demand while growing their portfolio safely and attaining financial profitability and thus sustainability.

The largest provider, VBARD, while beginning to diversify, has as its main objective to serve the rural market, and offers services that to a large extent are adapted to the needs of rural households. However, it reaches the poorer segment only through subsidized credit lines from donors (e.g. the add-on credit line for the poor under the ADB Rural Finance Project) or with performance guarantees from the Mass Organizations (it could also be argued that VBARD's persistent losses are another form of subsidy). VBARD appears not to be convinced yet that the poor might be a profitable market segment, perhaps because it cannot compete head-on with the subsidized VBSP. For VBARD to increase its own investment (of capital, risk share) in this market segment so that services will become more sustainable, (a) the competitive playing field with VBSP needs to become more level by the latter charging market rates, and (b) VBARD needs continued technical assistance to develop tools to assess, document, appraise and develop products and delivery systems for the bank to be able profitably to serve the poor. Systems developed e.g. by BRI in Indonesia may be particularly pertinent to the large SOCB.

The PCFs are possibly the most demand-oriented of the financial service providers in Vietnam at present by way of their savings-led and member-owned nature. However, even those that are operating profitably are not allowed to expand beyond the commune in which they have

registered which hampers growing their scale. To attain and retain their SBV license and an acceptable level of sustainability, they must balance their portfolio and cannot focus exclusively – or even primarily – on the poorer population segments in their commune. Slightly less stringent SBV licensing criteria related to area of operation (geography and coverage) for those PCFs operating profitably would enable more PCFs to open and grow their portfolio, hence serving more people – also among the BOP.

Only VBSP, one of the three main (formal) players in the financial services industry serving BOP, targets the poor directly, but it does so in an almost exclusively supply-driven fashion, driven by socio-political ‘coverage’ targets. For VBSP to become a successful microfinance retailer, it needs to be allowed to operate as a commercial bank, i.e. to charge cost-covering interest rates so that it can increase its savings and capital mobilization, and much earlier than 2020 as their plans call for. Simultaneously, VBSP needs to transform its entire organizational structure, culture and operations to become responsive to the market demand – by no means a small feat.

These same tasks must be accomplished by the institutionally weaker semi-formal MFPs that do focus squarely on the market segment of the poor, but often lack the necessary (banking) business skills. In addition, these MFPs, which have access to much less support from government, donors and receive less financial funds and technical assistance, must prepare for a quick and smooth transformation to legal institutions under new legislation and regulations which are not yet complete.

b) Operational systems and delivery mechanisms

The MFPs have had limited interface with each other and with the dynamic regional and international microfinance industry (even many of the international NGOs are multipurpose NGOs with limited microfinance expertise), and thus limited exposure to international standards of performance in microfinance. They have thus been sheltered from direct performance-based comparison with other providers, and consequently, their technical capacity is not well established. The product range offered to BOP households is supply-driven and standardized and somewhat focused on credit provision. Financial data recording and reporting in general is of a very low standard. Most MFPs are multi-purpose in nature and focus on social development issues with few having microfinance as their exclusive focus. Hence, the level of microfinance technical capacity and Good Practice knowledge and adherence is not high.

Among the regulated MFPs, VBARD has the strongest systems for commercial banking, but has not integrated microfinance into its product range as a specialized – and potentially profitable - service to poorer customers in its own right. Rather, the availability of cheap credit lines for on-lending has led the bank to increase rural outreach while the collaborative agreements with mass organizations have resulted in some down-scaling – but not, seemingly, as a result of an explicit policy to go down-market. VBARD could expand and adapt its product range to serve more and poorer customers; but the managerial focus, commitment and vision; and the specialized operational systems

necessary for high-volume, low-value services have not been promoted to any large extent. This is due to a number of factors: the existence of a large and more attractive middle-income rural market; the significant level of effort invested in the transformation from a protected SOCB to a competitive commercial bank in post- WTO-accession Vietnam; the losses still incurred in their mainline credit operations (which restrict their moving downscale), and the fact that the policy lender VBSP is seen to serve the market of BOP. VBARD will have to continue to focus on its internal transformation process towards greater efficiency and profitability with the aim of being able to seek market capital by 2010. The first priority of VBARD's management may not be necessarily to develop microfinance as a significant line of business in this transformation given that it may just be breaking even on its commercial banking products in 2005 and that the bank remains severely under-capitalized and in view of the constraint posed by the policy lender VBSP. However, should VBARD decide to enter more forcefully into microfinance, it would need to prepare, as part of its business plan, a range of products adapted to BOP. For this, it could benefit from regional capacity building, e.g. from BRI. An obvious starting point could be the introduction of low-threshold, liquid savings accounts.

VBSP is staffed primarily by former VBARD employees that are trained bankers and the combination of the policy mandate of targeted and subsidized credit and the lack of microfinance expertise in the policy bank has resulted in supply-driven service provision. VBSP is not profitable at present, and cannot become a sustainable microfinance provider unless it is allowed to charge cost-covering interest rates and develop its product range to serve the market it was established to reach – but at present, its policy mandate does not permit it to develop a vision and business plan to attain these objectives. Like VBARD, the policy bank faces significant capacity constraints in understanding its market, planning its business approach and adapting its operational systems, delivery mechanisms and customer orientation towards the changing demands of BOP. Moreover, having to focus on its policy mandate reduces its ability to serve its core clientele better. The comprehensive study of VBSP currently conducted by KPMG with World Bank support will no doubt detail and elaborate these constraints – but operational changes towards better microfinance provision within VBSP cannot be expected until the government releases VBSP from political controls and changes its interest rate policy.

VPSC has the potential to increase its marketing and provision of low-threshold savings accounts for BOP through its huge network – but there would be little incentive for VPSC to do this unless it can earn a profit from such increased deposit mobilization. This will only be possible if the GoVN eliminates the current policy which forces VPSC to transfer deposits to VDB and creates an implicit subsidy of VDB by VPSC through the differences of remuneration between the terms at which VPSC raises deposits and the rate at which it transfers them to VDB. Allowing VPSC to invest its deposits where sufficient revenue can be generated would be an incentive for VPSC to increase deposit mobilization (which now does not exist). However, with VPSC's currently limited number of customers and usage levels, staffing, (credit) banking experience, and outreach it is questionable whether additional support to VPSC would increase its role in microfinance provision.

VPSC's management indicated that its priority as a future commercial bank was to develop its urban network in the main cities and therefore there is little reason to believe that VPSC will expand its work mobilizing low-threshold savings, let alone providing credit for low income and poor people and other microfinance products.

The PCFs serve an important role in microfinance in Vietnam. As member-owned financial institutions at the local level, customers enjoy a degree of influence on financial service provision not found elsewhere in the microfinance sector. However, restrictions on their geographical outreach (they are generally limited to one single commune), even for profit-making PCFs, limits their ability to grow to the scale necessary for them to offer a broader range of microfinance services. Serving only one commune, does not allow them to offer the high-volume, low-value products demanded by BOP. Outside of the JSCBs (and VBARD), the PCFs, if allowed to gradually expand their area of operations as they become profitable and to receive financial and technical assistance from the CCF, currently appear to have the most potential for financial sustainability, but their managerial and technical sustainability remains low. In order to increase their interest in serving BOP, and thus develop more microfinance products, the PCFs would need legal permission and technical assistance to grow their scale of operations, strengthen internal controls, and diversify the product range. The DID-supported technical assistance project is piloting efforts in seven PCFs to improve their management and control systems, and the newly established Association of PCFs, supported by the apex CCF, is expected to address these issues as well. However, even if these efforts to improve the operational capacity of PCFs are successful, increased outreach will require relaxing the legal restrictions.

The existing semi-formal (I)NGO-supported MFPs in Vietnam serve the middle to low segment of BOP but have been constrained by their lack of legal status, limited technical capacity, and limited capital for growth. Most of the INGO-supported MFPs (but few of the schemes run by the Mass Organizations) have a clear vision and mission; and relatively well-developed strategies and plans. Solid private sector marketing and business development skills are limited, while planning skills are almost overly developed. The specialized MFPs (CEP, TYM, Vn-Plus etc.) have focused on results-oriented performance monitoring and have brought in technical assistance via donor projects (e.g. ILO trainings for MFPs in general, and CARD Bank and GSB support for TYM in particular). Most of the smaller MFPs are, however, run as 'projects' of Mass Organizations and do not have the managerial, technical and internal audit and controls capacity to track, record, report or analyze performance data from their operations. This group of providers therefore is less mature and specialized than the microfinance market requires.

Few MFPs have well-trained staff at all levels and even fewer the strategic management capacity or the business development skills that can help the organization grow, even if provided with better, more flexible and more needs-based training and mentoring over the coming years. Several training and TA resources for microfinance are available in the Asian region, which should be tapped into (if financing could be made available), including ARCM (Asia Resource Centre for Microfinance), EDA/MCRIL for ratings, and the CGAP-supported Microfinance Hub for Asia to which VIDC is linked. MicroSave Asia is being established in

India in 2006. The MFWG secretariat, once established, would be well placed to seek regional assistance for the industry.

Under Decree 28, licensing by the SBV will be a prerequisite for any MFP to continue financial service provision after March 2007 (when the two-year grace period for the Decree to take effect is expected to expire). Applying and obtaining a new license may prove less difficult, process-wise, in Viet Nam than has been the case for MFIs elsewhere. However, the ownership structure required, the capital requirements and the demand for ‘fit and proper’ owners and management for transformation pose a serious challenge, even for the larger MFPs, in part because of the lack of technical support available for this critical and wide-spanning task. It is encouraging that the SBV is considering to allow MFIs to incorporate as companies limited by guarantee⁹¹, as external technical competence could then be brought into Board- and management positions, if the necessary funds are available.

The insufficient technical capabilities the lack of independent space for decision-making, the low level of managerial strength, commitment and strategic capacity and the issues related to Decree 28 means that only three to five of the largest MFPs are expected to successfully transform into more formal MFIs.

c) *Organizational and Coordination Constraints at Industry level*

(a) Limited Coordination and Information Sharing

The provision of microfinance service is fragmented and coordination among the many stakeholders is very limited at all levels in the Vietnamese financial system. VBARD is a member of the Banks Association which interacts with SBV. But CCF and VBSP, not being “banks”, are not members. The PCFs have established their own Association, in which the other MFPs are not members. 44 semi-formal MFPs, but not VBSP, are part of the Microfinance Working Group (MFWG). And there are differences within the MFWG between the technically stronger and more exposed INGOs and the national, implementing stakeholders, who are most often representatives of Mass Organizations (the VWU). Informal coordinating channels do not exist to any large extent either. There is thus little direct contact and coordination between the semi-formal and the regulated MFPs who serve the same market and therefore little agreement on basic business definitions, standardized monitoring/success indicators, accounting standards or market information sharing to increase transparency and strengthen the industry.

The Mass Organizations occupy a central position in the political economy and in particular the Viet Nam Women’s Union (VWU) has a huge, nation-wide network of 12 million members, and a clear focus on the advancement of rural poor women. Some 40 savings and credit schemes sponsored primarily by international NGOs are executed in partnership with the VWU at Province, District and Commune levels all over Vietnam, and at central level, the VWU manages the second and third largest MFPs in Vietnam (by outreach): the VBCP and TYM. In addition to the framework contracts signed with both VBARD and VBSP, the VWU is thus legally ‘operating’ and collaborating – albeit in an uncoordinated manner - with almost all of the

⁹¹ Interview with NBCI department and MF Unit in SBV on 08/8/2006.

formal and semi-formal microfinance providers. But there is little contact, no agreed definitions of Good Practices and performance standards, no regulation or supervision of credit activities and very little sector-wide information and performance monitoring available.

This lack of coordination and mapping of current and potential outreach; and of agreed standards for performance based on current benchmarks and monitored over time through consolidation of reliable and accurate data from all providers of financial services to BOP hampers the building of a strong and accountable industry and increases transaction costs and risks, both for customers and providers.

Donors and other funders considering to invest in the more promising of the current MFPs must have better information on their financial performance and growth prospects and the likelihood of attaining financial sustainability within a reasonable period of time. At present, however, it is unlikely that schemes reaching less than 1,000 clients without specialized staff and visionary management; without a business plan documenting growth potential (market) with positive financial projections; and without basic financial and social performance data, will be of interest to any external funder.

(b) Role of the Mass Organizations in the Microfinance Sector

Vietnam's Party-led government structure has enabled Mass Organizations to be important stakeholders in the microfinance sector both at the policy and the operational level. However, it is evident that the role they should play in the future needs to be redefined in light of Decree 28 and in light of the comparative advantage of these institution in strengthening the microfinance industry.

The implication of Decree 28 is that all current Mass Organization (MO) microfinance projects would have to be constituted as separate legal and financially sustainable entities, or simply spun off (divested) with the MOs having the option of retaining ownership against an equity stake. Unless exemptions (thresholds) for small MFPs are provided in the Circulars for Decree 28, they will not be allowed to operate under the Decree.

The mobilization of poor women into savings and credit groups, offering access to basic training in group management, financial skills and non-financial Business Development Services (BDS) falls squarely within the mandate of VWU, and the VWU does possess significant comparative institutional strengths in promoting economic empowerment among the poor. It is not evident, however, that VWU as a political mass organization with a broad agenda would be interested in performing the arduous task of transforming itself in part or fully into a provider of market-responsive, sustainable and donor-independent microfinance. VWU has an excellent track-record as a *facilitator* of increased access by poor women to financial and non-financial services. However, it is not a good choice to become a formal and regulated microfinance service *provider*, competing with (or even replacing) VBSP. Indeed, like the other MOs, VWU does not necessarily aim at becoming a specialized microfinance institution and has been pioneering excellent alternative strategies:

- Several of the donor- and INGO-sponsored microfinance projects implemented in cooperation with the VWU have developed links to formal financial institutions for their clients, providing clients with sustainable access to credit as well as legal and professionally provided savings services. Of particular note is the Vietnam-Canada Rural Finance Outreach Project completed in December 2003, at the end of which VWU signed an Institutionalization Plan to roll-out specifically developed and successfully tested microfinance savings and credit products provided by VBARD to rural poor women mobilized into groups by VWU across the country. Similarly, at the end of the UNICEF-funded savings and credit project, clients were linked to banks, and the loan fund reallocated for capacity building. More recently Action Aid has handed-over its microfinance portfolio to local-level VWU units.
- Focusing the final phase of the VBCP on the mobilization and 'incubation' of very poor clients in groups accessing BDS and savings-led small loans; the 'graduation' of stronger clients to more sustainable providers; and increasing facilitation and coordination of demand-driven BDS supply at the local level rather than continued provision of microfinance .

B) Policy Constraints: Limited Policy Consensus and Distortions

Up until March 2005, when Decree 28 was issued, Vietnam did not have a legal framework for microfinance. And it could be equally argued, that there is no policy for microfinance or at least that a policy consensus has not been attained. The reasons for this include:

- The focus of the SBV and the main donors have so far and probably correctly been squarely on reforming the financial system at large. The challenges and issues of micro-finance had yet to attract significant attention, and the Government lacks a clear long term strategy for sustainable microfinance;
- There was and is still a widespread tendency to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be subsidized. This social approach is reflected in general Government policies for poverty reduction, and introduces two particular distortions:
 - The slow deregulation of interest rates through the SOCBs that implicitly limits the possibility of MFIs to set rates that can cover costs;
 - The existence of the Vietnam Bank for Social Policy (VBSP) that charges half the interest rates of VBARD, is tax-exempt and is guaranteed by the GoVN. The policies related to VBSP and to some extent, VDB, however well intentioned they may be, cause distortions in the system, reduce resource mobilization and can undermine sustainable microfinance providers.

The absence by and large of a coherent policy environment and of a commercially oriented microfinance industry reflects the widespread perception of microfinance, perhaps because of the dearth of other, equally visible, alternatives, as a poverty reduction instrument, different and thus excluded from the normal workings of the financial sector. In many respects it also reflects the larger financial sector concerns and challenges in the transition to a liberalized market economy.

The Microfinance Decree (Decree 28) provides the needed legal basis for semi-formal microfinance, but there does not seem yet to be an overall policy consensus on microfinance as an integral part of the financial system. In fact, the absence of this consensus on the role, functions and operations of microfinance has slowed down the development of the legislation. It remains doubtful that the operationalization in Circulars of Decree 28 will be able to provide the necessary legal and regulatory foundation for microfinance, as long as there are policy differences between the SBV and the Ministry of Finance with other political key stakeholders in Viet Nam.

It would thus be pertinent for these key stakeholders to consider reviewing some aspects of the policy environment as part of a comprehensive microfinance strategy with the aim to insert microfinance more fully within the financial system

C) Legal Constraints

With the promulgation of Decree 28 on the “*Organization and Operation of Micro-finance Institutions*” in March 2005, Viet Nam took an important step forward towards a more enabling policy framework for microfinance, despite the absence of a long-term strategic agreement among the key stakeholders in Viet Nam on the role, functions, and operations of microfinance in the country. In effect, SVB led the process of preparing Decree 28, but the pressure for an enabling legislation appeared to come more from international donors and INGOs than from the national stakeholders that could be affected by it, i.e. the Mass Organizations (MOs), including VWU⁹². The VWU has been issued an official letter by the Prime Minister allowing it to continue savings and credit activities to reduce poverty, which in principle is not overridden by the decree. Thus, these major players in the market have had little reason to advocate for change or to work with SVB to operationalize Decree 28. In addition, decree 28 does not apply to VBSP either and therefore it will not change its mandate, established also by decree, of providing credit to the poor at subsidized rates.

Decree 28 introduces a legal foundation for future microfinance activities, and provides legal and regulatory legitimacy to MFIs. It will contribute to greater transparency in the sector and to more specialized operations. While broadly formulated, it includes most normally accepted provisions for microfinance legislation, especially with regard to safeguarding deposits received by intermediating MFIs⁹³. The decree does not acknowledge, however, that good practice on microfinance legislation does not generally imply a prudentially strict regulatory regime for all providers, large and small, as systemic risk from the intermediation of deposits is in many cases limited, but rather a basic legal foundation, facilitating the transformation of semi-formal, typically NGO-led schemes into commercially legitimate microfinance institutions, that can pursue the ‘double bottom line’ of financial services to the poor in a sustainable manner. Moreover, The lack of a

⁹² Interview with Mrs. Hop, SBV, in Vietnam Microfinance Bulletin, Issue 5 August 2005.

⁹³ For a detailed review of the Decree, see Doan Anh Tuan: Viet Nam’s New Law on Microfinance: On the Way to an Enabling Environment, SCUS, December 2005.

microfinance strategy and the apparent lack of consensus on operational issues has slowed considerably the issuance of the operational Circulars of Decree 28

The Decree splits MFIs in two types of regulated institutions:

- MFIs not permitted to take voluntary savings, required to have a legal capital of VND 500 million (US\$ 31,250), and
- MFIs permitted to mobilize voluntary savings, required to raise a minimum legal capital of VND 5 billion (US\$ 310,000).

The Decree does not resolve the key issue of ownership and strongly favors the need for commercial clarity of a financial institution⁹⁴. The Decree does not allow private entities to establish MFIs; only MOs and Vietnamese (non-profit) NGOs (for which there is no specific legislation in Vietnam) can own licensed MFIs, which must be legal entities with a Business Certificate and a separate governance structure. Other Vietnamese and foreign organizations may, however, contribute capital as minority owners. The ownership issue could impede microfinance development, as opening markets to privately-owned entities normally encourages capital flows that may now not be forthcoming. SBV is currently partial to allowing MFIs to register under the Enterprise Law as companies limited by guarantee in addition to Decree 28. This would facilitate private sector participation, but will require that the Circulars under Decree 28 clearly determine that microfinance-specific charts of accounts, accounting practices and prudential ratios which are not necessarily part of the Enterprise Law, be given precedence in order to better reconcile the existing accounting regulations for Enterprises with Good Microfinance Practices. Other concerns with the Decree include the following:

- The Decree makes no allowances for the continuation of credit and savings at any scale unless the activity is licensed, subjecting all microfinance in Viet Nam to licensing under the Decree.

In most developing countries, small and localized, member-based savings and credit operations are exempted from formal licensing, as they represent limited or no systemic risk, and as the capacity of any central bank to supervise all such schemes is constrained. SBV subscribes to this view⁹⁵, but will naturally have to develop the circulars of operations within the framework provided by the Decree.

- In the Decree, current activities must be covering operational costs to obtain a license. However, only around a third of the current semi-formal programs are operationally sustainable at present, and they must thus find a sponsor to cover their losses until such time as revenue covers costs – or take the perhaps more feasible decision to phase-out and divest their microfinance portfolio to more promising financial service providers.
- The Decree provides a grace period of 24 months (which expires in March 2007) for current programs to process an application for a license. As the Decree

⁹⁴ "Preparing the Framework for Microfinance Development", PWC & Enterplan, Revised Draft Final Report, September 2004.

⁹⁵ Interview with SBV's NBCI Department and Microfinance Unit in August 2006.

leaves a number of issues to be determined in more detail through guidelines and circulars (regulations) to be developed by SBV and MOF, the SBV seems to favor an extension of the grace period to start at the issuance of the first Circular, but this has not been granted. The first Circulars are expected to be issued only in October 2006 which provides insufficient time and incomplete information (since not all Circulars will be issued together) for the MFIs to meet the deadline.

- The capacity of the newly established 3-person Microfinance Unit in SBV to produce and get approval for the circulars is limited. Given the number of circulars to be issued and capacity constraints, requirements will not appear in one batch of regulations. A total of seven separate circulars⁹⁶ are planned, relating to:
 - Organization and scope of Operations – the actual licensing framework;
 - Geographical coverage - criteria for opening branches;
 - Directives for Owners and Management – criteria for qualifications;
 - Prudential ratios and reporting requirements;
 - Directives on credit methodologies (to be developed by the SBV monetary policy department);
 - Requirements for the Chart of Accounts (to be developed by the Accounts department);
 - Regulations for on- and off-site supervision.

In addition, the Ministry of Finance will develop regulations pertaining to financial systems management.

Thus, there is a concern that the regulatory framework that may emerge may not be internally consistent and coherent and may lack the necessary flexibility to allow for corrections as the need arises. This would render the task of preparing license applications by prospective applicants and the transformation process itself very difficult. If the Decree takes effect as planned on March 2007, the few specialized microfinance operations run by MOs and INGOs that currently cover at least operational costs need to start planning for transformation with a view to apply for an MFI license. All those schemes that have scant possibilities for reaching at least operational cost recovery will not be allowed to continue operations, unless the Decree is not modified (or the Circulars take a pragmatic approach and introduce changes), or unless they can find a sponsor to cover their likely deficits. A lot of the current microfinance schemes in Vietnam will therefore have to think rapidly and hard about their future or plan to spin-off their microfinance operations. In the process it should be expected to see divestitures, mergers, and a general consolidation in the market. On the other hand, it is possible that the decree will only be partly or unevenly implemented and that it may not in the short term provide the desired level of legal legitimacy and operational independence that sustainable microfinance needs to grow to scale and sustainability.

⁹⁶ Ibid.

D) Conclusions: Conditions for Enhanced Access to Finance

The overall political and economic environment for microfinance in Vietnam is stable and improving. The economic dynamism and the overall financial reform program in Viet Nam provide a solid foundation for the integration of sound microfinance into the overall financial system, enabling the financial system to serve the majority of the population inclusively.

Microfinance as a sustainable financial service business approach targeting the poorest segment of society is not well established in Vietnam, and there is no strategy for microfinance as such reflecting a somewhat immature market. There is still a widespread tendency to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be fed by subsidies. This creates a number of policy distortions that combined with a legal and regulatory framework in transition and institutional weakness, requires attention and a number of decisions by the government, as suggested in the previous section.

The demand among the poor and low-income households of Viet Nam today is for well-designed, affordable and customer-responsive financial products delivered flexibly and conveniently. Most micro-customers will prefer to use one provider for all their financial needs, but the extensive multiple borrowing evident in Vietnam indicates that few providers are fulfilling this broader demand, and customers are left to compose a suitable financial services package from the multiple available sources and product ranges. The rapid expansion of credit offered by the formal financial system which reaches deep into the BOP segment, and reports from INGO programs in the field also indicate an increasingly segmented market and sophisticated demand by the poor for larger and differently structured loans as well as for a broader range of services, including micro-insurance, leasing finance and remittances.

The increasingly narrow niche markets of very poor households and micro-entrepreneurs in more remote areas needs to be served by more flexible, specialized and demand-driven services. The well-tested methodologies introduced and operated among the semi-formal MFPs should be gradually extended to the very poor in the most remote and rural communities furthest from formal bank outlets. Semi-formal MFPs should try to achieve better market penetration in communities of ethnic minorities, who are clearly the segment of the population most adversely affected by poverty, and least served. To focus on this market segment and at the same time increase sustainability, however, will require MFPs to continue to be free to set interest rate levels to cover the higher costs and to achieve a higher level of innovation, efficiency and adaptation than it exists today.

In the middle market segment of the poor, MFIs under Decree 28 will need to compete for market share against VBSP and in a market also covered by the formal institutions in the upper range of the market and by the Mass Organizations in the lower segment. Even innovative MFIs may find it hard to keep costs within the squeezed financial margins of

the Vietnamese market in general, but no MFI with the double bottom line objective of serving the poor sustainably can compete *on price* with the government-subsidized VBSP. Thus the need to review the policy on interest rates.

To carve out a share in the well-served Vietnamese market for financial services to BOP, any MFP or new entrant considering registration under the Decree 28 would have to have the management, the product range and the capital available to grow the portfolio to scale quickly in order to attain sustainability. They will need to strengthen their internal management and operational systems so that they are able efficiently to handle larger and more diversified portfolios. And finally, they will need to improve their financial management, recording and reporting (transparency) to be able to demonstrate a level of financial performance that could attract the capital necessary to enable the required portfolio growth while efforts should be stepped up to 'graduate' resourceful clients to the formal providers which could serve their broader demand better, leaving the limited capital of the semi-formal MFPs to be available for the poorest segment.

In the much more competitive and diversified market segment of the low-income households and MSEs, the larger, more established and better capitalized main players (VBARD, the PCFs and VBSP) require better market information, appraisal tools and systems to meet the growing and diversifying demand more responsively. Targeted external credit made available for intermediation will not necessarily support the internal development process of understanding how the BOP market segment can become profitable. With the VBSP in the market, which is mandated to offer a lower interest rate than any sustainable MFP could, competition cannot be on price – it has to be on quality, and the key quality concern of the poor is permanent access (thus sustainability) to appropriate products (thus innovation).

The future microfinance market in Vietnam will have no room for providers that manifest diluted focus, scattered outreach, and limited skill. The MFPs that will succeed will be those characterized by business-orientation, good market research and open to customer-feedback so that providers can strengthen, adapt, adjust and innovate their products and delivery systems to respond to the changing market demand and the increasing demands by the low income and the poor for quality, consistency and responsiveness. With the competition and the limited financial margins, only the most professional and efficient operations that are able also to serve the under-served remote areas of the country are likely to succeed in the longer term. Not all the institutions presently operating in Vietnam will be able to do so and closures, consolidations and mergers should be expected as potentially successful microfinance emerge in the currently immature industry.

The key to successful financial service provision to BOP will also lie in the ability of providers to develop their risk management, controls skills and systems of delivery so they can cost-effectively reach a critical mass of clients and generate a profit to the institution. This means maintaining good portfolio quality (PaR of less than 5%), and attaining financial self-sufficiency (being able to cover all direct and indirect costs of operations by income earned from the operations). A sustainable scale (break-even point) in Vietnam is roughly estimated to be 3000-5000 customers or a loan portfolio of around US\$ 1.5 million for savings-led

institutions (PCFs) at their current efficiency levels,⁹⁷ and at least US\$ 500,000 for credit-led MFPs⁹⁸ lending at the current SOCB rates of around 12% p.a. Outside of the formal (regulated) financial system, very few MFPs (9 of the 44 MFPs reporting to the Microfinance Working Group) in Vietnam have attained such a scale.

Developing a credit reference system will help improve coordination and information sharing on customers and avoid (or reduce) the high but undetected level of multiple borrowing in Vietnam and the risk of portfolio failure. The already existing linkages in the microfinance market through the widely applied Framework Agreements between VBARD, VBSP and the Mass Organizations need to be strengthened so that the “graduation” of bank-ready clients from informal and semi-formal to formal microfinance institutions can be expanded.

The market for business support services to microfinance in Viet Nam needs to be strengthened. There are few specialized providers, and potential providers in the rapidly expanding private sector have not established linkages to the clients (market) of microfinance providers. This is due in part to the isolation of the nascent, development-oriented microfinance industry from the general business community, which is typically seen in industries dominated by governments, social organizations and to some extent INGO-funders and donors that bring in-house expertise to their programs and do not necessarily explore options for service provision in the national market place. It is illustrative that two of the lead INGOs in microfinance, ILO and SCUS, are considering the establishment of an “NGO training center” rather than perhaps contracting training services from existing resources within the private business service sector.

The direct lobbying of the SBV has clearly increased the visibility and legitimacy of the MFWG, the informal microfinance network of practitioners. However, the coordination and communication between MFWG and the donor agencies needs to be improved as witnessed in their inability to help develop a more enabling legislation and more timely regulations. Moreover, the MFWG seems to have missed – or avoided – the opportunity to work closely with the key microfinance stakeholder ‘by default’, the Women’s Union. The Women’s Union participates in the MFWG, but there is a need to further cement a solid lobbying alliance of the technically stronger INGOs in the MFWG core group, who could advocate and formulate good microfinance practices, and the politically well-connected and respected Mass Organization, which could promote the key concerns and suggestions from ‘inside’ the highest level of government. This potentially strong alliance would benefit both the microfinance industry and the SBV in producing and obtaining government approval of good-practice based Circulars under Decree 28.

The overall policy debate on microfinance as a self-sufficient financial business segment with a social mission rather than a poverty lending instrument needs to be reenergized between the Government, the institutions in the sector, the donors and the Mass Organizations who currently manage the vast majority of semi-formal microfinance. The uncertainties over

⁹⁷ Estimated from the Report on PCF’s Performance, 31 March 2006, where PCFs at this size on average break-even. The 7 model PCFs supported by DID appear to perform better, but their average Financial Self-Sufficiency ratio remains a little below break-even at 98.5%.

⁹⁸ Estimated from the MFWG_Basic Data on MFOs by 31 March 2006.

policies as manifested in the development of an enabling legislative framework under Decree 28 and the lack of a coherent strategy need to be addressed.

This new dialogue should help develop an overall consensus among all stakeholders on the adoption of a coherent strategy for a microfinance sector adhering to performance-based, results-oriented good practices in an inclusive financial sector. It is hoped that this report (Volumes I and II) will contribute to this dialogue, to the success of this unique market and to the development of Vietnam.

Annex 1: Terms of references for the Assignment

1. BACKGROUND

The reform agenda of the Government of Vietnam, which began in earnest in 2001, was based on a comprehensive multi-year program. The reform agenda itself continues to be in flux. The debates and pronouncements concerning accounting standards, banking regulations, liberalization of interest rates, and the entry of foreign banks, all are reflective of this continually moving reform agenda. In 2003, the SBV adopted a new reform strategy (which is now being updated again to reflect the five year plan to 2010) which will include the development of plans for the reform of the entire banking sector and the development of the capital markets. However, there does not appear to be a clear vision of the Government for the next five years on the issue of expansion of access to finance, the related role of policy lending institutions in the economy, and the channels of financing support for the poor, such as the mix of welfare, training, subsidized credit, and other state-sponsored programs and market-based services.

The implementation of reforms has been reflected in the rapidly rising level of formal financial intermediation in the country. Confidence in the banking system has grown rapidly as evidenced by the rapid growth in deposits from 43 % of GDP in 2000 to 56 % in 2003. In addition, credit to the economy has grown at a similarly rapid pace, averaging a rate of over 25 % per annum. Research indicates that in 1992, 73 % of rural credit was provided by the informal sector—in 2002, that figure had dropped to 11 %.

Despite the impressive progress and increasing formalization of the financial sector, Vietnam still lags behind the region on these indicators and there are still inadequacies in the efficiency of financial services for the poor in Vietnam. The level of poverty in Vietnam remains high despite the rapid economic growth over the past ten years. It is estimated that by 2004, 26 % of the population, or about 21 million, was classified as poor based on the international standard of US\$1 per day of income. It appears that the overall outreach of formal finance to the poor, primarily in rural areas, is growing, but still only approximately 32 % of the poor had debt from formal institutions. Of those with access to finance, most received their financing from two institutions: the state-owned Vietnam Bank for Agriculture and Rural Development, or VBARD (23 %) and the Vietnam Bank for Social Policies, or VBSP (58 %). Other banks only provide about 1 % of the credit to the poor and the 900 People's Credit Funds (regulated by the SBV) provide access for only 3 % of the poor. Thus, the other 15 % of the poor access funds from a variety of other semi-formal and informal sources, with Non-Governmental Microfinance Institutions (MFIs) making up 8 %, followed by relatives and friends (7 %) and money lenders (4 %). Beyond the financial institutions (formal and informal) providing credit, there are programs administered by the Government, such as health and education programs for the poor, that have subsidized credit programs embedded in them, but are not generally counted as providers of microfinance.

The many disparate players in the microfinance market have created fragmented approaches, regulations, and impacts in the sector. For example, VBARD operates as a commercial bank offering market-based loans, but the VBSP is a special non-profit bank that offers subsidized

credit to eligible borrowers. There is wide variety amongst the other institutions providing credit to the poor. This fragmentation has resulted in some specific concerns about the extent to which subsidized operations will undermine the sustainability of the microfinance market. Survey evidence already suggests that the existence of subsidized credit is distorting the market and that the poor do not realize that the rates charged by the VBSP are in fact not market rates. In addition to these concerns, the formal institutions, VBARD and the VBSP, both face corporate governance, technological, operational, risk management, and capacity constraints, which given the rapid pace of their credit expansion, could generate potentially large fiscal liabilities for the Government in the future.

On the savings side of the ledger, few households in poor communes save through formal mechanisms, such as bank accounts. The formal micro-finance institutions (VBARD and VBSP) also provide savings products at the same interest rates, but the VBSP has not been able to mobilize any substantial amount of deposits to date. That said, another formal sector financial institution is beginning to play an increasingly larger role in expanding access to savings, the Vietnam Postal Savings Corporation (VPSC). The VPSC is young, only established in 1999, but it has made impressive progress and will soon provide basic financial services (primarily savings and payments) through 920 post offices (out of 2,946). This is the second largest financial services network in the country and the VPSC plans to extend services to all of the post office outlets. Nearly 400,000 individuals keep accounts with the VPSC, and it has mobilized about VND 4.7 trillion as of July 2004, which was only about 1.5 % of the total value of the market. However, the VPSC is constrained by a number of factors, primarily strict limitations on the services it can provide and the investments it can make its non-transparent relationship with the post, its lack of connection to the national payment system, and the limited modernization of its operations. The establishment of a more extensive range of facilities for profitable cash savings will be an increasingly important mechanism to help poor households make better investments and manage risks.

2. OBJECTIVES

Access to finance is one of the four pillars of the WB's overall strategy and is an essential element of two reform agendas in Vietnam—financial sector development and poverty reduction. Expanded access to formal finance not only facilitates the efficient mobilization and intermediation of funds in the economy, but it also allows the poor to protect, diversify, and increase their sources of income. The WB has and continues to focus on expanding access to finance in Vietnam through two inter-related approaches: top-down (macro-level focused on policies and regulations) and bottom-up (micro-level focused on institutions and operations). However, there is no comprehensive analytical assessment of the microfinance landscape in Vietnam, nor is there a strategy to transform the regulatory framework and all of the institutions involved in the provision of microfinance. Therefore, the objectives of this project are threefold:

- (i) to assist the World Bank in gaining an understanding of the microfinance landscape in Vietnam – the full range of institutions, both formal (banks, VBSP, MFIs, PCFs, etc.), semi-formal (credit components of Government programs, Women's Union, etc.), and informal (money lenders, family, etc.), that are providing access to micro-

finance products and services (savings, credit, payments, etc.) to low-income households and micro-businesses;

- (ii) to provide the World Bank with the basis for developing a comprehensive strategy for improving microfinance in Vietnam in terms of outreach, efficiency, and sustainability based on international best practices – the strategy will consider various options for transforming institutions, regulations, and policies in the sector; and
- (iii) to inform and positively influence the key policymakers and stakeholders in Vietnam, as well as the donor community, involved in the microfinance sector.

3. Scope of Work

The consultants are expected to provide the following work items:

- (i) Inception Report presenting the initial understanding of the assignment and the preliminary findings and thesis based on desk research and input from the World Bank.
- (ii) Survey of a representative sampling microfinance providers, formal, semi-formal, and informal, as well as end-users of microfinance and the regulators of these institutions.
- (iii) Progress Report on the survey, research, and analysis of the microfinance landscape and strategy.
- (iv) Final Assessment Report on the microfinance landscape in Vietnam. This report should include a qualitative and quantitative analysis of the microfinance providers in the economy. This analysis could include financial performance, subsidy dependence indices, corporate governance review, and other relevant and standardized methods. The report should also include a qualitative and quantitative comparative analysis to selected microfinance environments, as well as institutions, worldwide.
- (v) Final Strategy on improving microfinance in Vietnam in terms of outreach, efficiency, and sustainability based on international best practices and options for transforming institutions, regulations, and policies in the sector.
- (vi) Dissemination workshop to present to the World Bank and relevant stakeholders in Vietnam the findings of the research and the recommended strategy for improving the microfinance sector.

4. Expected Outputs and Timeline

The consultant shall provide two final written reports and one dissemination workshop, as well as all other deliverables defined in Section 3 above. All outputs will be reviewed and commented on by the World Bank before final acceptance. All reports will be in English and Vietnamese. The project is expected to take 2 full months in terms of man hours, but it is likely that these projected timeline for delivery of the outputs is as follows:

Number	Deliverable	Timeline
1	Inception Report presenting the initial understanding of the assignment and the preliminary findings and thesis based on desk	June 2006

	research and input from the World Bank.	
2	Survey of all types of microfinance providers and end-users	July 2006
3	Progress Report on the survey, research, and analysis of the microfinance landscape and strategy	August 2006
4	Final Report on the microfinance landscape in Vietnam	September 2006
5	Final Strategy on improving microfinance in Vietnam in terms of outreach, efficiency, and sustainability based on international practices	September 2006
6	Dissemination workshop to present to the World Bank and relevant stakeholders in Vietnam the findings of the research and the recommended strategy for improving microfinance	October 2006

5. Consultant Qualifications

The project requires the services of a Spanish consulting firm.

- (i) The firm’s team should be made up of experts with experience in financial sector development, particularly in microfinance and access to finance issues. Ideally, the firm should have in-depth experience with sustainable microfinance institutions and
- (ii) The team should have at least one member who speaks Vietnamese as it will be necessary to review decrees, regulations, reports, etc. related to the subject as well as to facilitate meetings.

6. Implementation Arrangements

The World Bank will:

- Provide the consultant with all relevant and available information and reports on the microfinance-related issues generated by the World Bank and available sources, such as reports by the ADB, ILO, and other institutions. A list of available documents will be provided to the Consultant by the World Bank at the time of selection.
- Facilitate meetings for the consultants with the relevant departments within the SBV and Government agencies, banks, and other relevant institutions.
- Provide limited work space at the offices of the World Bank Country Office in Hanoi.

The Consultant will:

- Conduct independent research on the microfinance sector in Vietnam and comparative countries from available sources;
- Meet the Scope of Work in Section 3 and delivery all materials as detailed in Section 4.
- Be responsible for its own equipment needs;
- Include in the estimated budget proposal coverage for transportation, subsistence as well as for all translation services associated with the assignment;
- Maintain complete confidentiality of all information and materials acquired during the course of the consultancy.

7. Reporting and Ownership of Outputs

Reporting will be to the following individual of the World Bank:

Mr. James Seward
Financial Sector Specialist
Private and Financial Sector Development Unit
East Asia and Pacific Region
The World Bank
MSN MC8-811
1818 H Street, NW
Washington, DC 20433, USA
Tel: (202) 458-7547
Fax: (202) 522-3454
Email: jseward@worldbank.org

The ownership of the materials developed during the assignment will rest with the World Bank.

8. Special Coordination Provision

During the course of implementation of consultancy services, the consultants will co-ordinate and consult with other donor agencies that are implementing or planning related technical assistance projects on relevant issues to access to finance.

Annex 2: Program and work plan for the Assignment

			July					August					September			
Activity (Work)	Respon.		26	3	10	17	24	31	7	14	21	28	4	11	18	25
Phase 1: Desk Research																
Task 1.1	Desk Research	All Team														
Task 1.2	Contacts with the World Bank in Vietnam to obtain additional documents	TL/LC														
Task 1.3	Determine MFIs to contact	TL/MF/LC														
Task 1.4	Seek quantitative data sources and complement data	LC														
Task 1.5	Study Regulatory Framework	RA														
Task 1.6	Preliminary views on issues in MFI that need to be addressed	TL/MC														
	<i>Deliverable: Inception Report</i>	14 July			○											
Phase 2: Survey and Interviews																
Task 2.1	Prepare Survey, obtain data, analyze data	MF/LC														
Task 2.2	Analysis of the microfinance landscape and strategy	TL/MF														
Task 2.3	Desk Research	RA														
Task 2.4	Analyze survey results and provide summary of mayor findings	MF/LC														
Task 2.5	Fieldwork involving interviews and surveys	All Team														
	<i>Deliverable: Interim Report</i>	Aug 16														○
Phase 3 : Develop Comprehensive Strategy and Assessment of the MF Sector																
Task 3.1	Qualitative and quantitative analysis on the MF	TL/MF														
Task 3.2	Strategy for improving MF in outreach, efficiency and sustainability	TL/MF														
Task 3.3	Options for transforming institutions, regulations and policies	All Team														
Task 3.4	Obtain information on comparative selected environments of MF	RA														
Task 3.5	Obtain data on financial performance, subsidy dependance indices, corporate governance review, other standardized methods	LC														
	<i>Deliverable: Final strategy</i>	4 Oct.														○
	<i>Deliverable: Draft Final Report</i>	22 Oct														○
	<i>Deliverable: Final Report</i>	29 Oct														○
Phase 4 : Dissemination Workshop presentation																
Task 4.2	Prepare documents and dissemination workshop	TL/MF														

Annex 3: List of Persons Met

Institution	Name	Position	Department
Asian Development Bank, Vietnam Resident Mission	Kanokpan Lao-Araya	Head	Finance, Trade, Governance and Private Sector
Bank for Investment and Development of Vietnam (BIDV)	Nguyen Huy Tua	Director	Transaction Center III
	Nguyen Manh Hung	Manager	Project & M&E Division, Transaction Center III
	Pham Quoc Khanh	Staff	Planning and Development Division, BIDV
	Nguyen Minh Khoi	Staff	Credit Services Department, BIDV
	Cao Cu Tri	Head of division	Legislation Division, Transaction Center III
	Pham Mai Khanh	Vice Head of Division	Legislation Division, Transaction Center III
	Pham Quoc Cuong	Head of Project Appraisal Division	Project Appraisal Division, Transaction Center III
	Pham Hong Van	Staff	Transaction Center III
Bao Viet	Dang Thi Hong Phuong	Director	
	Bui Tuan Trung	Manager	Non-Listed Equity Department
Binh Minh CDC	Dinh Anh Tuyet	Manager	Ha Noi Head Office
	Duong Thi Kieu Huong	Administrative Officer	Ha Noi Head Office
	Nguyen Thanh Ha	Field Credit Officer	Regional Office, Dong Anh district, Hanoi
CECI Canada	Bernard Wyler	Country Program Director	
Central People's Credit Fund (CCF)	Nguyen Thac Tam	Head	International Relations & Project Management Division
Desjardins Development International (DiD)	Ngo Thi Minh Hien	Project Office Manager	Project Support to the Development of PCFs Network in Vietnam
European Commission Delegation	Hans Farnhammer	1st Secretary	Economic Cooperation Section

European Commission Delegation	Dirk Gerlach	Team Leader	Rural Development and Environment Cooperation Section
International Fund for Agricultural Development (IFAD)	Nguyen Thanh Tung	Policy Development Officer	Asia & the Pacific Div, Field Liaison Office, Vietnam
International Finance Corporation (IFC)	Margarete O. Biallas	Manager, Financial Markets Development Program	
International Labour Organization (ILO)	Valerie Breda	Associate Expert	
	Nguyen Thi Bich Van	National Project Coordinator	Microfinance Project
Kreditanstalt für Wiederaufbau (KfW)	Tran Hounh Giang	Project Manager	
Mekong Delta Housing Bank (MHB)	Huynh Nam Dzung	Chairman	
	Chu Huyen Trang	Officer	
Ministry of Finance (MoF)	Duong Duc Minh	Deputy Chief	Banking Division
	Tao Lan Hounh		Department for Banking and Financial Institutions
Ministry of Planning and Investment (MPI)	Ms. Phan Thi Thanh Ha	Deputy Director	Financial & Monetary Department
	Tran Van Son	Expert	Financial & Monetary Department
Ministry of Labour, Invalids & Social Affairs (MOLISA)	Nguyen Hai Huu	General Director	Social Protection Department
Save the Children (US)	Nguyen Tuyet Mai	Micro Finance Program Officer	Economic Opportunities
Small and Medium-Sized Enterprise Development Fund (SMEDF)	Nguyen Chi Trang	Project Director	
	Ho Thi Thu Hounh	Project Manager	
	Philippe H. Guitard	Technical Assistance Team Leader	
State Bank of Vietnam (SBV)	Dang Anh Mai	Deputy Director General	International Cooperation Department

	Truong Ngoc Anh	Deputy Director	Banks and Nonbank Credit Institutions Department
	Dr. Tran Quang Khanh	Director	Cooperative Institutions Department
	Quach Tuong Vy	Deputy Chief - Head	Microfinance Unit, NBCI division, Bank and NBCI Department
	Ha Thi Thanh Thuy	Officer	Microfinance Unit, Banks and Nonbank Credit Institutions Department
	Nguyen Van Ngat	Director	Thanh Hoa Branch
	Nguyen The An	Vice Director	Thanh Hoa Branch
	Do Tien Phuc	Head of Credit Institution Division	Thanh Hoa Branch
State Committee for Ethnic Minorities (CEM)	Tran Van Thuat	Director of Department of Policies for Ethnic Minorities	
Techcombank	Nguyen Duc Vinh	Chief Executive Officer	
The World Bank	Nguyen The Dzung	Operations Officer	Hanoi Resident Mission, Rural Development
	Noritaka Akamatsu	Lead Financial Economist	Finance & Private Sector
	Trieu Quoc Viet	Finance Sector Specialist	Hanoi Resident Mission
TYM Fund	Duong Thi Ngoc Linh	Deputy Director	Hanoi Resident Mission
	Joerg Teumer	Management Consultant	German Savings Banks Foundation
Vietnam Bank's Association	Nguyen Trong Ngo	Senior Director	Legislation and Banking Dept.
Vietnam Bank for Agriculture and Rural Development (VBARD)	Vu Van Trinh	Director	Credit Department
	Nguyen Viet Hung	Deputy Director	Project Management Department
	Tran Van Thanh	Deputy Director	Thanh Hoa Branch
	Trinh Ngoc Thanh	Deputy Director	Thanh Hoa Branch
Vietnam Bank for Social Policies (VBSP)	Nguyen My Hao	Deputy General Director	
	Tran Lan Phuong	Deputy Director	International Cooperation Department
	Le Huy Du	Deputy Director	International Cooperation Department
	Pham Ba Nguyet	Director	Thanh Hoa Branch

Vietnam Development Bank (VDB)	Ho Thi Thanh Ha	Deputy Director	Foreign Capital Management & Int'l Relations Department
	Nguyen Thanh Nam	Specialist	Foreign Capital Management & Int'l Relations Department
	Nguyen Chi Trang	Director	Planning and Coordinating Department
	Nguyen Van Quang	Deputy General Director	
Vietnam Export Import Commercial Joint Stock Bank (EXIM)	Dang Van Quang	Director	Hanoi Branch
Vietnam Postal Savings Service Company (VPSC)	Cao Thi Hoai Duc	Deputy Director	
	Pham Thi Ngoc Ha		H.R. and Admin Division
	Tran Ngoc Tung	Director of district Post Office	Nong Cong PS, Nong Cong district, Thanh Hoa province
Vietnam Women's Union	Cao Thi Hong Van	Co-Director, VBCP	VBCP, Social and Family Division
	Pham Thi Ha	Vice Head of Division	Social and Family Division
	Nguyen Thi Quynh Ngoc	staff	Social and Family Division
	Thai Quang Trung	Staff	Social and Family Division
VWU, District	Le Thi Van	Head of VWU	Nong Cong district, Thanh Hoa province
	Le Thi Thanh	Vice-Head of VWU	Nong Cong district, Thanh Hoa province
	Le Thi Nhung	staff of district WU	Nong Cong district, Thanh Hoa province
VWU, Commune	Nguyen Thi Anh	chairperson of commune WU	Van Hoa commune, Nong Cong district, Thanh Hoa
	Le Thi Chien	vice-chairperson of commune WU	Van Hoa commune, Nong Cong district, Thanh Hoa
	Nguyen Thi Thi	member of commune WU Standing Committee	Van Hoa commune, Nong Cong district, Thanh Hoa
VWU, Village	Do Thi Khuong	head of village WU	Dong Luong village, Van Hoa, Nong Cong, Thanh Hoa

	Le Thi Hoan	head of village WU	Quyet Chien village, Van Hoa, Nong Cong, Thanh Hoa
	Le Thi Hao	head of village WU	Dong Tho village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Thi Tuyet	head of village WU	Thieu Na village, Van Hoa, Nong Cong, Thanh Hoa
	Cao Thi Phuong	Village credit officer	Thieu Na village, Van Hoa, Nong Cong, Thanh Hoa
	Dau Thi Oanh	head of village WU	Cam Phuc village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Thi Chinh	head of village WU	Ngoc Ban village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Thi Thom	head of village WU	Tung Thien village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Thi Thien	head of village WU	Cam Bao village, Van Hoa, Nong Cong, Thanh Hoa
	Le Thi Hiep	Chairperson of Commune WU	Van Thien commune, Nong Cong district, Thanh Hoa
	Nguyen Thi Lien	Credit Officer, village WU	Cao Nhuan village, Van Thien commune, Nong Cong district, Thanh Hoa
	Sinh	Credit Officer, village WU	Quyet Thanh 1 village, Van Thien commune, Nong Cong district, Thanh Hoa
	Sang	Head of village WU	Cong Hoa village, Van Thien commune, Nong Cong district, Thanh Hoa
People's Committee, District	Tran Van Thuan	District PC chairman	Nong Cong district, Thanh Hoa province
	Le Viet Dung	Officer, district PC Office	Nong Cong district, Thanh Hoa province
PC, Commune	Le Van Them	Commune officer	Van Hoa commune, Nong Cong district, Thanh Hoa
PC, Village	Hoang Trung Que	Head of village	Thanh Dien village, Van Hoa, Nong Cong, Thanh Hoa

	Do Thien Ba	Head of village	Cam Phuc village, Van Hoa, Nong Cong, Thanh Hoa
	Dau Tam Dong	Head of village	Cam Bao village, Van Hoa, Nong Cong, Thanh Hoa
	Le Van Dam	Head of village	Dong Luong village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Thanh Chuong	Head of village	Dong Tho village, Van Hoa, Nong Cong, Thanh Hoa
	Le Quang Nam	Head of village	Tung Thien village, Van Hoa, Nong Cong, Thanh Hoa
	Nguyen Manh Hung	Commune PC chairman	Van Thien commune, Nong Cong district, Thanh Hoa
	Phu	Village head	Truong Son village, Van Thien commune, Nong Cong district, Thanh Hoa
	Hoi	Village head	Cong Hoa village, Van Thien commune, Nong Cong district, Thanh Hoa
	Dai	Village head	Cao Nhuan village, Van Thien commune, Nong Cong district, Thanh Hoa
	Sang	Village head	Quyét Thanh 1 village, Van Thien commune, Nong Cong district, Thanh Hoa
	Hung	Village head	Lien Minh village, Van Thien commune, Nong Cong district, Thanh Hoa
	Le Van Hoang	District PC chairman	Ba Thuoc district, Thanh Hoa province
	Khang	Vice head , district PC office	Ba Thuoc district, Thanh Hoa province
People' Credit Fund, Long Van	Dinh Quang Nho	Director	PCF Long Van, Ba Thuoc district, Thanh Hoa
	Pham Thi Lien	Chairperson of Director Board	PCF Long Van, Ba Thuoc district, Thanh Hoa
	Le Anh Hung	Chief Accountant	PCF Long Van, Ba Thuoc district, Thanh Hoa
	Tran Thi Ngoc	Chief of Credit Division	PCF Long Van, Ba Thuoc district, Thanh Hoa
	Truong Phuc Tham	Chief of Monitoring Division	PCF Long Van, Ba Thuoc district, Thanh Hoa
	Pham Ba Nguyet	Staff	PCF Long Van, Ba Thuoc district, Thanh Hoa

Villagers (end-users)	Le Thi Tam	End-user	Cao Nhuan village, Van Thien commune, Nong Cong district, Thanh Hoa
	Nguyen Thi Thi	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Nguyen Thi Mien	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Nguyen Thi Chinh	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Dau Thi Oanh	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Nguyen Thi Tuyet	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Le Thi Hao	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Le Thi Hoan	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Do Thi Khuong	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Le Thi Chien	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Vu Thi Mac	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Le Quang Nam	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Le Van Dam	End-user	Van Hoa commune, Nong Cong, Thanh Hoa province
	Nguyen Thi Loan	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
	Pham Thi Can	End-user	Van Thien commune, Nong Cong, Thanh Hoa province

Dong Thi Sang	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
Nguyen Thi Liem	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
Tran Thi Xinh	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
Le Van Hoi	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
Vu Quang Phu	End-user	Van Thien commune, Nong Cong, Thanh Hoa province
Dong Khac Sang	End-user	Van Thien commune, Nong Cong district, Thanh Hoa
Le thi Tam	End-user	Van Thien commune, Nong Cong district, Thanh Hoa
Tam	End-user	Nong Cong district center, Thanh Hoa
Nguyen Thi Ly	End-user	Minh Nho commune, Nong cong, Thanh Hoa
Nguyen Thi Ty	End-user	Cao Nhuan village, Ba Thuoc district, Thanh Hoa
Truong Thi Nga	End-user	Lam Xa commune, Ba Thuoc district, Thanh Hoa
Vu Thi Thu	End-user	Ba Thuoc district, Thanh Hoa province
Le Minh Tuan	End-user	Canh Nang town, Ba Thuoc district, Thanh Hoa
Nguyen Thi Long	End-user	Canh Nang town, Ba Thuoc district, Thanh Hoa
Bui Thi Vinh	End-user	Canh Nang town, Ba Thuoc district, Thanh Hoa
Truong Thi Lich	End-user	Canh Nang town, Ba Thuoc district, Thanh Hoa
Nguyen Thi Nga	End-user	Lam Xa commune, Ba Thuoc district, Thanh Hoa

	Pham Thi Khuyen	End-user	Ai Thuong commune, Ba Thuoc district, Thanh Hoa
	Ha Thi Luong	End-user	Ai Thuong commune, Ba Thuoc district, Thanh Hoa
	Truong Thi Phuong	End-user	Ai Thuong commune, Ba Thuoc district, Thanh Hoa
	Ha Thi Mai	End-user	Ai Thuong commune, Ba Thuoc district, Thanh Hoa
	Truong Thi Quy	End-user	Ai Thuong commune, Ba Thuoc district, Thanh Hoa

Annex 4: The Key Microfinance Suppliers

1. Formal (regulated) Microfinance Service Providers

The Vietnam Bank of Agriculture and Rural Development (VBARD)

As one of the five state-owned commercial banks in Vietnam, VBARD is mandated to serve the rural financial market, and is the largest bank in Viet Nam. It has a nationwide network of 2,096 branches up from 1,881 As of end 2004, covering some 600 districts in all of the 64 provinces. In some areas, VBARD also operates mobile units, financed under the World Bank Rural Finance Project I. Through its inter-communal branch network, VBARD is responsible for over 50% of all loans made to rural households, and VBARD's clientele consists of 68% rural borrowers, primarily farmers. The average loan size is around VND 21.1 million (US\$ 1,320), reflecting its primary focus on small rural enterprises and middle-income earners.

While VBARD does not directly target low income-earners, donor-funded programs and targeted credit lines (from the World Bank, ADB, KfW and ADF) and framework agreements with the Mass Organizations (in particular the Women's Union and Farmer's Union) have provided the bank with a substantial rural credit portfolio also reaching BOP. VBARD estimates 47% (end 2003) of its rural borrowers or some 2.8 million households to be poor, making VBARD the largest provider of the full range of microfinance services (savings, credit, money transfers etc.) in rural Viet Nam.

Mobilizing a significant US\$ 12.5 billion in deposits from the public, VBARD intermediates 60% as loans. The removal of government restrictions on interest rates in May 2002 has enabled VBARD to operate on a more commercial basis and has increased its profitability in recent years. However, the policy that institutions are required to provide loans at subsidized rates to households living in remote (Zone 3) areas continues to restrict the commercial operation of formal financial institutions. While the subsidies are funded by the Government, reimbursement is reportedly delayed, which may have reduced VBARD's incentive to expand lending in remote areas⁹⁹. A significant part of the loan portfolio for poor rural households is financed through the 82 projects implemented with donor funds at a total value of US\$ 2.8 billion of which \$ 2 billion is loan capital to be disbursed through VBARD.

The Vietnam Bank for Social Policies (VBSP)

The only formal financial institution directly mandated to deliver microfinance in Vietnam today is the Vietnam Bank for Social Policies (VBSP). In 2002, the Viet Nam Bank for the Poor, which used to operate through the VBARD branch network, was reconstituted as the VBSP with its own nationwide branch network of 64 provincial branches, 662 transaction offices at district level and 8,076 commune-level transaction points, all subsidized by and often co-

⁹⁹ ADB: Rural Credit Project Performance Evaluation Report, November 2005.

located with the Local People's Committees (LPCs). As the key government vehicle to channel social transfers as subsidized credit for policy purposes, VBSP is fully guaranteed by the Government, and is exempt from taxes, state budget remittances, and the deposit insurance scheme (DIV). One of the few good outcomes of the creation of VBSP as a policy lender has been the consolidation of the many credit lines to the poor formerly administered through line ministries; VBSP has taken over preferential lending schemes from MPI, MOLISA, People's Committees at all levels, and from the SOCBs.

As of June 2006, the VBSP' reported a total outstanding portfolio is VND 18 trillion (US\$ 1.1 billion) to a total of 4,4 million clients, of whom 3,8 million are LIC holders (poor) – or more than the total number of low-income households in Vietnam as per the latest GSO estimate (24% of the population in 2004), but these figures are unadjusted for multiple loans to the same customers and to some extent cumulative, as VBSPs capacity to effectively collect old outstanding debt and track active versus frozen loans is limited. The average loan size to poor households has increased since 2004 to around VND 4.6 million (US\$ 293)¹⁰⁰.

VBSP mobilizes some 53% of its loan capital from public deposits (end 2005) and receives additional capital for lending from donor funds (IFAD, OPEC, WB) and a mandatory contribution of 2% of the deposits of the SOCBs, with the balance coming from the State budget in yearly tranches. Given the low level of resource mobilization and VBSP's dependence on government transfers, it must ration its provision, resulting in poor clients often not being eligible for a second or subsequent loan.

The interest rate has recently (January 2006) been raised from 0.5% to 0.65% per month, but it is still well below the market rates applied by practically all the other MFPs. The heavily subsidized nature of its lending renders it financially unsustainable and unfairly undercuts competitors in the market, including VBARD and any MFI presently operating in Vietnam or to be established under Decree 28. Hence, VBSP distorts the micro-credit market and in competitive areas, it represents a threat to any sustainable microfinance institution in the market. Its basic assumption that the poor are not able to afford market interest rates is increasingly under questioning in Vietnam and has been proven consistently wrong everywhere in the world; permanent access to sustainable financial services that are provided reliably has proven to be more important to customers than low interest rates loans provided by unsustainable institutions. There is no reason why Viet Nam should be different.

Because of the social policy mandate, VBSP is not only likely to continue to operate in the immediate future, but may actually increase and expand operations if provided with sufficient government resources. As cautiously indicated by the current management and as it is widely believed necessary by most policy-makers in Vietnam, VBSP may gradually start to align its interest to market rates, thus reducing both the level of distortion and the drain on government budgets. Other options include the transformation of (a part of) VBSP away from retail microfinance provision in an increasingly crowded

¹⁰⁰ World Bank (2004), Financial Sector Policy Issues Note: Viet Nam Bank for Social Policies quoted in ILO 2005, and interview with VSBP management on 27 July 2006.

and competitive market and into a wholesale refinancing institution serving the current and future microfinance providers under Decree 28, meeting their interim need for low-cost capital and funds for capacity building until such time as they reach the scale and proficiency levels that will enable them to cover costs and access commercial capital.

The Viet Nam Postal Services Company (VPSC) this is not a MFP!! We could delete it?

As a provider working exclusively on the savings side, *The Viet Nam Postal Services Company (VPSC)* was established in 1999 and is operated under the authority of Viet Nam Post and Telecom (VNPT). As of July 2006, the Company, which only has 150 staff, operates through 816 outlets (post offices) of which 186 are on-line, and pay a commission to VNPT per transaction carried out.

Its main functions are to mobilize resources, 15-25% of which are on-lent at sub-market rates, to the Vietnam Development Bank (formerly the Development Assistance Fund) to provide medium term lending at subsidized interest rates to finance public development investment projects by SMEs and exporters. A second function of VPSC is to provide basic financial services for the under-served (rural, women, and poor) population segments. 60-70% of time deposit customers are women, but at an average balance of US\$ 812/account, these customers do not generally fall within the BOP population segment. Some 80,000 individual savings accounts at an average value of US\$ 500 are held primarily by civil servants, while the VPSC offers a "collection account" product with small monthly deposits (average balance of US\$ 278) aimed at and well-suited for poorer farmers. Currently, some 20,400 depositors utilize this service¹⁰¹.

While the VPSC is a for-profit company and did report a small profit in 2005, its resource mobilization is governed by targets set by MPI. Perhaps as a result of these targets and the margins obtainable for the company, the VPSC does not appear to market the savings services widely, and the number of deposit accounts has remained stable since 2001, at around 500,000 (501,902 by July 2006), but the total value of savings mobilized has increased over the past three years to VND 6,511 billion (US\$ 382 million) as at mid 2006, the vast majority (80%) placed in time deposits of 3-24 months bearing an interest of 7.2-8.8% p.a., similar to the SOCBs.

In 2005, a PMO Decision¹⁰² opened up for the expansion of basic financial services to be offered by VPSC through the extensive postal network to include remittances, utility bill payments, checks and POS cards) and two pilot projects are ongoing to test the market for IC cards, and utility bill payments, but VPSC requires an SBV license to operate these services, which has not yet been granted.

With its very limited current product range, popularity in the market, and staffing structure, it is not evident that the VPSC will grow to become a major player in microfinance, and the company plans for the future also appear to go in a different direction: VPSC aims to become equitized through international (minority) shareholding as a bank serving the Post and

¹⁰¹ VPSC: Powerpoint presentation, July 2006 and interview with management on 28/07/2006.

¹⁰² Decision 270/2005/QĐ-TTg of October 31, 2005

Telecom sector. It is questionable whether the financial sector in Vietnam needs another sectoral banking institution in addition to the five 'financial companies' serving the industries of construction, shipping, rubber, textiles and petroleum respectively.

People's Credit Funds (PCFs)

People's Credit Funds (PCFs) are community-based financial cooperatives that are owned, operated and governed by shareholding members, modeled after Desjardins (caisses populaires) and established by Decree in Vietnam in 1993 following the collapse of the old cooperative system in 1989. PCFs are licensed under the Cooperative Law and supervised by the SBV on their adherence to set standards regarding financial management, and member capacity. The SBV appraises new PCFs prior to licensing, and supervises and classifies the performance of the PCFs based on on- and off-site inspections. In 2000, some 40% of operating PCFs were classified as 'weak'. Since then, a total of 120 have closed down, and 60 new PCFs have been established. As of June 2006, the SBV considers the system as financially strong and regards only 6 of the 926 existing PCFs to be under-performing¹⁰³. The average value of total assets of a PCF is VND 8 billion (US\$ 500,000).

An initial share contribution of VND 50,000 makes members eligible to save and take individual loans. As of June 2006, the 926 PCFs operating at the commune level have a total of 1,046,472 members (approximately 35% women) of which 30-40% are estimated to be poor. Savings mobilized As of March 2006 totaled VND 5,441 billion, providing some 80% of loan funds. The total outstanding loan amount by June 2006 was VND 8.5 trillion (US\$ 531 million), with an average loan size of VND 8.1 million (US\$ 508), indicating a portfolio of primarily less poor members¹⁰⁴.

Acting as an apex in the PCF network, the Central Credit Fund (CCF) attracts and mobilizes capital from shareholders (the PCFs and the 4 SOCBs), donors and public deposits, serves commercial and urban customers from its 24 regional branches (loans from the CCF branches average US\$ 750), and supervises and intermediates funds to the local PCFs at a near-market rate of 8% p.a. The CCF was established with a one-off contribution from GoVN of 80 VND billion in 1995 and is regulated by the Credit Institution Law, and is supervised by the State Bank of Viet Nam. CCF is receiving TA from GtZ for institutional strengthening, and with TA from DID, CCF is piloting a modernization process for 7 PCFs, and aims to establish a central reserve fund to cover losses from any failing member PCFs to enhance the overall sustainability of the network. In 2005, a new association of People's Credit Funds (PCFs) was established to coordinate and standardize the operational policies of the PCFs, including credit risk management and accounting¹⁰⁵.

In addition, some 300 of the approximately 900 Agricultural Production Cooperatives in Vietnam began to provide limited savings-based credit services following the adoption of a Decree¹⁰⁶ allowing for internal savings and credit services. 100 of these were recently

¹⁰³ Interview with Cooperative Credit Institutions Department of SBV, 03/8/2006 and ILO: Working Paper Series no. 5.

¹⁰⁴ SBV: Summary report of the PCF's Performance, March 31, 2006.

¹⁰⁵ Taking stock, op.cit.

¹⁰⁶ SBV Decree 06/2004/TT-NHNN of 27 September 2004.

reviewed by the Ministry of Agriculture (MARD)¹⁰⁷ and reported a total number of borrowers around 16,500 of whom about 20% also saved with the cooperative. The average savings balance of \$ 163 per account indicates that cooperative savers are not generally among the poorest, but a number of these cooperatives do provide loans to poorer members within the range of \$ 50-500 against partial collateral and at rates of 12% p.a. Some cooperatives also provide loans in kind (input, seeds, seedlings) to members.

The Insurance Companies

On the insurance side, the regulatory framework in Vietnam differentiates between life and non-life (property and assets including crops and livestock, health, and disability) insurance companies (except Bao Viet) have to choose between a life and a non-life license. Vietnam initially offered licenses to new entrants in 1999 with no limits on foreign ownership of life companies.

Among the 17 companies licensed to provide insurance services in Vietnam, 3 are state-owned (Bao Viet, Bao Minh and Petro Vietnam Insurance Company); 5 are fully foreign owned insurance companies (Allianz-AGF, Groupama (agricultural insurance only), Prudential (UK), Manulife and AIA (USA)); 4, including the Vietnamese-Australian Bao Minh CMG, are joint ventures insurance companies; and 5 are joint stock insurance companies. While the majority of the companies hold non-life licenses, Bao Viet Life, Prudential, Manulife, AIA and Bao Minh CMG have life licenses. In addition, 3 insurance brokers are in operation in Vietnam and around 20 overseas insurance companies have representative offices in Vietnam.

The life insurance market in Vietnam is young, started only in 1996 when the state-owned Bao Viet insurance monopoly was converted into the Vietnam Insurance Corporation (still referred to as Bao Viet and with equitization planned for 2010) and granted a composite license (i.e. all life and non-life lines). Since 1980 Bao Viet has set up a nationwide network to provide services throughout the country. Bao Viet and Prudential each have around 40% market share by life premium income (2004), and the top three companies (including Manulife) command around 90% of the market today. Life insurance premium income grew at an annual rate of 67% from 1999-2004 before taking a pause in 2005, but life insurance premiums still accounted for only 1% of GDP in 2005.

The non-life insurance market (property and assets, fire and health) is expanding rapidly and non-life insurance sales in 2006 to end June totaled VND 3.2 trillion (US\$ 189 million) representing a growth of 25% year-on-year. Viet Nam has 15 domestic companies selling non-life insurance, but Bao Viet (32% of total premium sales) and Bao Minh (24%) dominate also the non-life market.

The tied agency channel is the backbone of the insurance industry in Vietnam. It is estimated that at the end of 2005, there were some 92,000 tied agents, but their level of experience is

¹⁰⁷ MARD: Internal Credit Services within the Agricultural Production Cooperatives.

low, resulting in short tenures and very high turn-overs. This has contributed to poor agency productivity and fraud which is now being addressed by the industry¹⁰⁸.

The Government runs two insurance-related products of potential relevance to BOP:

Social security System

Social security: In 1995, the Government of Vietnam introduced social security legislation for all establishments in the public and (formal) private sector with more than 10 workers (SMEs). With the large informal sector in Vietnam and with 46% of all enterprises being MSEs with less than 10 employees, it is estimated that the social security only reaches some 11% of the labor force. For those covered, the following benefits are provided against a premium of 15% of the payroll contributed by employers and a 5% contributed by the employee:

- Retirement pensions
- Work accidents and industrial diseases
- Sickness benefits
- Maternity leave benefits
- Survivors benefits

The intention of the government is to extend social protection to all workers. The Labor Code stipulates that compulsory and voluntary methods will be used to achieve the goal of protecting all workers and their families. However, there are currently few voluntary members of social security. One barrier may be the level of contributions demanded; a 20% deduction on the average salary for insurance purposes may be too high for informal sector workers.

Health Insurance

Health Insurance: The Vietnam Social Security Agency (VSSA) administers a compulsory and a voluntary health insurance scheme and issues (theoretically) free health care cards for children under 6 under the health insurance regulation which came into effect in January 1999. By 2000, however, only 10.5 million people (13% of the population) were covered by health insurance;

- The compulsory health insurance scheme has been targeting mainly the formal sector, and public and private sector workers employed by enterprises with at least 10 workers (SMEs) have been required to join. Once a member, workers are entitled to both outpatient and inpatient treatment at all levels, but the insurance does not cover dependents, even if a significant discount is offered to workers for enrolling their entire families. The premium contributions are 2% of payroll by employers and 1% of salary by employees. There is a 20% excess payment for all members except social priority groups and pensioners;
- Members of the voluntary health insurance scheme enjoy the same benefits as mandatory holders for a similar premium, which ranges from VND 60,000 – 100,000 in rural areas and VND 80,000 – 140,000 in urban areas per person per year (half for children and students). Like the mandatory scheme, the voluntary health care

¹⁰⁸ Mark V.T. Saunders and Adrian Liu: Life Insurance 2/2006: "Vietnam a new star in the east" and Vietnam Insurer's Association quoted in VietNam News 21 August 2006.

insurance is facing declining enrollment, due to lack of trust in delivery, lack of customer-care, and complex administrative procedures. In some areas, however, the Mass Organizations, e.g. the VWU is collaborating with the VSSA to encourage households to enroll;

- As part of the HEPR program, the Free Health Cards for the Poor scheme was introduced in 2002 and is administered by the Health Care Fund for the Poor, which is funded by the State budget (75%), local authorities and ODA contributions. The Fund is responsible for buying health insurance cards for the poor with a premium of VND 50,000 per person per year or reimbursing actual expenses of health care for them. By end 2003, only some 20% of entitled households (1.85 million persons) were granted a free health insurance card, and 2.5 million people received free health care, with significant geographical and quality variations¹⁰⁹.

2. *Semi-formal providers*

Mass Organizations (MOs)

Both VBARD and VBSP have signed Framework Agreements with Mass Organizations (MOs) in many areas to reduce their cost and risk, which has made it easier for many poor to access the banks. MOs organize their (poorer) members in groups, provide crucial legitimacy in the loan application process, and act as informal guarantors for the clients. The group leader assists in the loan transactions, for which the MO and the group leader receive a small commission. The loan documents are signed with the borrower as an individual. This linkage system has clear advantages for all parties. The banks get easy access to mobilized borrowers that repay, the MOs retain their members, and the more enterprising MO members that want to expand and grow their businesses get access to the full range of banking services, including increasing loans.

The Viet Nam Women's Union (VWU) has been the chosen MO collaborator for many INGOs due to its effective outreach at the grassroots level, and it is currently implementing some 40 savings and credit schemes. Of these, the Viet Nam-Belgian Credit Project with 54,000 active borrowers and the TYM Fund with 19,900 borrowers and a combined outstanding loan balance of VND 99.7 billion (March 2006) are the largest. The VWU has no specialized financial implementation units, but has integrated the savings and credit operations with other (primarily social) activities, employing its existing staff and organizational structure. With external TA via the CASHPOR network and the German Savings Bank, the TYM has however developed a level of autonomy within the VWU.

Currently, some 57 (I)NGOs implement microfinance programs in Viet Nam, most in collaboration with the VWU as the legal framework has required involvement of MOs. INGO schemes are generally small and geographically scattered; many operate in a few communes within one district only¹¹⁰. While global microfinance also serves urban poor,

¹⁰⁹ ILO: Risk Management Financial Services available in Vietnam, <http://www.microfinance.org.vn/office.htm>

¹¹⁰ "Non-Governmental Organisations' Microfinance Programmes in Viet Nam", SC-JV and JBIC, Oct. 2003.

most semi-formal microfinance in Viet Nam is provided in rural areas¹¹¹. The Viet Nam Microfinance Bulletin published by the Microfinance Working Group (MFWG) counts 284,400 borrowing clients reached by 44 programs As of March 2006, with a total outstanding loan balance of VND 758 million (US\$ 47.4 million) up by 109% from 362 million (US\$ 22.8 million) in September 2005, and VND 430 million (US\$ 26.9 million) in mobilized (and often intermediated) savings¹¹².

In total, the semi-formal market may reach in the vicinity of 300,000 clients at present, and offer small loans and savings services well adapted to the poor, but less suitable for entrepreneurial clients needing larger loans for longer terms.

3. *Informal providers*

There is a long tradition of informal *Rotating Savings and Credit Associations (ROSCAs)* in Viet Nam. These groups are referred to as 'Phuong', 'Ho' in the North and 'Hui' in the South. In the ROSCAs, periodic (weekly, monthly or more frequent) contributions in cash or in kind (rice) from members are pooled and disbursed to one member at a time on a rotating basis sometimes with, but usually without interest. Normally, members come from the same ward or village and membership averages 10-15 persons. Interest rates, membership and loan amounts are decided on either jointly, by a bidding process or by the organizer (group leader). The life cycle of a ROSCA ends when every participant has had at least one loan. ROSCAs are commonplace in Vietnam and build on trust-bonds among members living in close proximity or e.g. trading in the same market place.

Within all of the Mass Organizations, a slightly more formalized version of ROSCAs exists at the village level. As part of the membership 'requirements', members contribute a fixed sum per year (VND 20,000 – 50,000) and these funds are lent out to members in difficulties for 1-3 years at a time, with (WU, YU at 6-12% p.a.) or without (VVU, FU) interest. In addition, staff from Vietnam Social Insurance (VSSA) who disburse pensions and benefits at village level will often collect a share of the disbursement and lend them to pensioners in need. These savings and credit groups are well established in almost all communes, and appear well appreciated by people as part of the collective social safety net.

As in most other developing countries, *money lenders* have been an important source of informal credit in Viet Nam. By nature, the money lender tends to be the richer people in the communities, who provide character-based short-term credit at high interest rates (2-4% per month). Interestingly, there are reports that money lenders have started to reduce their lending rates as a consequence of the increasing outreach of formal and semi-formal financial service providers. In addition, *pawn shops* exist in most towns. *Traders* in the local markets and to some extent input suppliers and bulk-buyers of produce will provide informal pre-financing for producers or sell on credit to established customers.

¹¹¹ Exceptions include the CEP Fund that operates in the HCMC area, and the SCUS-supported microfinance program administered by BMCDC in the suburbs of Ha Noi.

¹¹² MFWG: Basic Data on MFPs As of 31 March 2006 and compared to The Vietnam Microfinance Bulletin, Volume 7, March 2006, which presented data As of September 2005.

Annex 5: The key external providers of credit lines for access to finance

Donor/Lender	Terms of Loan	Purpose/scope	Loans and Value in US\$
World Bank (IDA)	<p>IDA loans: 40 yrs at no interest, 10 yrs grace at 0.7% to GoVN .</p> <p>GoVN lends to BiDV for 25 years w/ 8 years grace at min. 3% and BiDV lend to FIs at min. 5% (2% spread)</p>	<p>RFII's RDF: MLT loans through BIDV to 18 PFIs (currently 6 JSCBs and VBARD and CCF).</p> <p>Microfinance Loan Fund under RFII: Short- and MT loans to 7 MFIs (95% to VBARD, PCFs) to lend to rural poor, households and MEs</p> <p>Agricultural Diversification project: credit line for SMLT loans through VBARD to farmers</p>	<p>Rural Finance II (5/02): \$200m</p> <p>Rural Finance I: \$ 110 mn 3rd PRSC (6/04): \$100mn</p> <p>2nd Banking Reform loan (3/05): \$ 105</p> <p>4th PRSC (6/05): \$100mn</p> <p>5th PRSC (6/06): \$ 100mn</p> <p>\$ 84.2 million</p>
Asian Development Bank	<p>ADF Loan: 32 years at 1.5% p.a., 8 yrs grace (at 1% p.a.). MoF lends to VBARD/CCF for 20 years, HOs lend to branches/ PCFs for 1-5 years at sub-market rates</p> <p>Housing Finance Loan: ADF loan (as above)</p> <p>SME Sector development Program loan w/ KfW and AFD</p>	<p>Enterprise Finance: targeted credit line for MSEs and poor HHs through MoF to CCF and VBARD</p> <p>Housing finance</p> <p>SME loans</p>	<p>Rural Enterprise Finance Project: US\$ 70.2 million, hereof US\$ 70.7 m for credit</p> <p>US\$ 30 million, hereof 5 million for microfinance</p> <p>US\$ 47 mn of which \$40 mn is disbursed</p> <p>Finance Sector Progr.Loan II</p>
AFD	<p>Co-funding ADBs Finance Sector Program Loan II</p> <p>SME Sector development Program loan w/ ADB and KfW (credit line to VBARD)</p> <p>Loan and TA to MHB</p>	<p>Bank restructuring</p> <p>SME loans and medium-term loans to farmers and NFMEs</p> <p>For long term housing credit for infrastructure and employment generation in the Mekong Delta</p>	<p>Euro 55 million</p> <p>Euro 35 million</p> <p>Euro 25 million</p>
KfW	<p>Revolving Credit Fund for VBARD: 10-15 year loans, 10 yr grace, 9 %-points under end-user interest rate.</p> <p>Co-funding SME Sector development Program loan w/ ADB and AFD.</p> <p>Credit line to ICBV for private sector investments by</p>	<p>Finance for the rural poor: 4 credit lines provided through MOLISA to VBARD (3) and directly to VBARD (1). Two remain open, and are being evaluated and phased out by late 2006.</p>	<p>Euro 19 million total, 7.6 million in open credit lines.</p> <p>Euro 20 mn total, 7 mn disbursed.</p> <p>Euro 5.1 million</p>

	Vietnamese returnees: 40 yr loan w. 10 yr grace at 4.5% under end user rate.		
Gov't of Spain	Cooperative Credit	Credit line to CFF for the PCF network	Euro 15 million
EU	Grant for revolving loan fund under VDB; 5-8 year loans 1 yr grace, repayment semi-annually either with fixed rate (GoVN 5-yr bond issue rate) or floating rate (6- months deposit rate)	MLT SME finance: revolving fund through the SMEPF to Incombank (SOCB) and ACB, Sacombank and Techcombank (JSBs). SMEDF awards performance- based credit based on projected demand as per the applicant institutions' business plans	US\$ 18,125,000 (VND 290 bn)

Annex 6: Verification Survey of Financial Service Providers

During the Field Mission to Vietnam in July-August 2006, a survey was conducted to verify the findings of the recent in-depth survey on Microfinance in Vietnam¹¹³. In order to facilitate cross-country comparison, the survey questionnaire developed by the team built on the World Bank template provided and was adapted to the Vietnamese market prior to its translation into Vietnamese. The result was two near-identical but tailored questionnaires; one for regulated banking institutions and one for non-banks (e.g. Leasing companies and Agricultural Production Cooperatives with credit services) and non-regulated Microfinance Providers (i.e. the semi-formal operators).

The two questionnaires were presented for comments to the World Bank and the State Bank of Vietnam (SBV) prior to their dissemination, and their advice was sought in composing the list of recipients. The SBV gracefully agreed to manage the dissemination of the questionnaires and thus, during the week of 27 July 2006, a total of 137 questionnaires in Vietnamese were distributed to as many financial service providers (FSPs) in Vietnam. The questionnaires and the list of recipients were presented in the progress report dated 14 August 2006.

As of mid September, a total of 68 completed questionnaires had been received, equivalent to a response percentage of 50%. The breakdown of distributed and received questionnaires is as follows:

FSP type	# questionnaires distributed	# completed questionnaires received	Response %
SOCBs	6 (5 + 1 branch)	6 (5 + 1 branch)	100%
JSCBs	37 (25 urban and 12 rural JSBs)	15 (12 urban, 3 rural)	Urban: 48% Rural: 25%
JV and Foreign banks	10 (5 JVB and 5 Foreign banks)	2 (both JVBS)	JVB: 40% Foreign: 0%
Fin. Companies:			
VPSC	1	1	100%
Leasing Comp's.	5	4	80%
Policy/Non-Banks:			
VDB/VBSP	3 (2 + 1 branch)	2 (1 + 1 branch)	50%
Insurance comp.	2	0	0%
Mos	1	0	0%
PCF network	CCF + 42 PCFs	CCF + 25 PCFs	60%
Agric. Prod. Coops.	13	3	23%
Semi-formal MFPs	16	9	56%
Total	137	68	49.6%

A summary of the information reported in the questionnaires by the individual retail providers is presented below. Not all respondents were able to respond fully to all questions, and some questions may also have been less than clear, resulting in answers which might have been different, had there been time and opportunity to discuss the questions in detail. Where

¹¹³ Hong Son Nghiem & James Laurencson: The nature of NGO microfinance in Vietnam and stakeholders' perceptions of effectiveness. East Asia Economic Research Group, Discussion Paper No. 3, October 2005, School of Economics, The University of Queensland. Queensland.

responses have seemed misunderstood, data has been sought verified in secondary sources, provided by the SBV, CCF and MFWG etc.

To specifically triangulate the responses received from the individual retail providers, the Team requested SBV for data related to the overall composition of the credit and deposit market in Vietnam as summarized in two matrices. The Team was very fortunate to meet with exceedingly helpful and accommodating support from the Department of International Relations, whose staff diligently compiled this information from the various departments of SBV and forwarded it to the Team via the World Bank Mission with letter of 12 September 2006.

In broad terms, the findings from the questionnaires confirm the findings of the in-depth survey conducted in 2005. In the reports, the survey responses have been utilized to illustrate points and descriptions of the microfinance landscape (see Volume I, Chapter 5) and as background data for the development of the Strategy (See Volume II).

The Team would like once again to thank the SBV and all the respondent institutions for the time and effort invested in completing the long questionnaire within the short time frame available.

Summary Results of Survey conducted as part of the 'Access to Microfinance' Study for the World Bank, July-August 2006

No. of questionnaires disseminated: 137
 No. of questionnaires returned: 68 50%

	Type of Respondent:	Banks:			NBFIs:			Coops:		MFPs	
		SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-formals	
S#	No. questionnaires:	6	37	10	1	5	42	13	1	16	
	No. respondents	5	15	2	1	4	25+ CCF	3+100	1	9	
A7 i	Number of branches	2430	244	5	1	3	25+24	3	662	165	
ii	Number of non-branch outlets	257	134	2	816	2	39	2	8076	2057	
iii	Number of ATMs	1770	294	4	0	0	0	0	0	0	
A8i	% urban branches/outlets	75-100%	80-100%	100%	35%	100%	12.50%	10%	15%	12-75% (2)	
A9i	Total number of full-time employees	46973	10571	230	160	230	213	411	5999	1216	
ii	% female	54%	52%	50%		53%	32%	27%	48%	87%	
iii	No. of part-time employees	0	0	0	2448	0	61	9+	6942	93	
C2i	Total no. credit officers	1395	3636	44	0	118	104	111	1,715	702	
ii	% female	5.40%	11.14%	41.25%	0	41%	26%	27%	28%	92%	
A11	Core market segment										
	Corporates/MLE	60% (3)	13% (2)	50% (1)							
	Personal banking		13% (2)	50% (1)	50%						
	SMEs	60% (3)	80% (12)	50% (1)		90%	33%	x			
	MSEs	20% (1)	20% (3)			10%	83%	x		10%	
	Poor HH/individuals	20% (1)	47% (7)		50%		37%	x	100%	90%	
A13	No. customers										
	No. borrowers	9,375,572	215392	635		1494	14,342	16542	4125000	150830	
	% female	38%	34%	79%		32%	38%	21%	47%	93%	
	No. savers		268825	15,885	464,119	507	8871	3475	3548	144829	
	% female		51%		80%		37%	8.30%		92%	
	No. other customers		238256		1			558			
Developing a Comprehensive Strategy to Access to Micro-Finance			Deposit payments, money transfer		VDB			Inkind loans		117	

		Banks:			NBFIs:		Coops:		MFPs	
Type of Respondent:		SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-formals
Deposit Services										
B1i	#f current accounts		266,105	631						
B2i	Range current a/c	min. 100,000	100,000 - 10 mn							
iv	Value of Current a/c	\$ 9.1 bn	\$ 232.4 mn	\$ 143 mn						
ii	# savings a/c	7,000,000 (1)	454,552	544						
B2ii	Range savings a/c	min. 150,000	100,000 - 10 mn							
v	Value savings a/c	\$ 7.6 bn	\$ 2.64 bn	\$63,437						
iii	# term a/c	10,000,000 (1)	326,865	18,802						
B2iii	Range term a/c	min. 100,000	100,000 - 10 mn							
vi	Value term a/c	\$ 8.5 bn	\$ 231.3 mn	\$ 109.8 mn						
B1ii	# voluntary savers				464,119	507	8421	3475	3548	61767
iii	Value vol. savings						\$ 6.4 mn	\$568,000	\$616,500	\$94,197
i	#r compulsory savers						450			83062
B2i	Range compuls.savings									3,000-9,000/w
B2iv	Value compuls. Savings									\$ 2.5 mn
Accessibility										
B5	Opening a/c	Any outlet	Any outlet	Any outlet	Any outlet		HO	HO	Any branch	Branch or non-branch
B7ii	% of applic rejected	0	0.5-15%	3%	0		0	60%	0	0
B8	Reasons why		Lack of residence ID	Lack of residence ID				Members have savings		Membership, loan
B9	Liquidity	Fully liquid	generally liquid	Relatively liquid	Semi-liquid		vol. = liquid	Semi-liquid	vol = liquid	vol = liquid
B10	Interest on current	2.40%	2.4-3.6%	1.80%						
	Interest on savings	2.4-6 %	2.4-3.6%	6%						
	Interest on term	7.8-9.36%	7-9.24%							
	Interest on vol. savings						3.6-11.2%	7.2-12%	2.40%	2.4-6%
B11	Interest on compuls						9.72%		2.40%	2.4-6%
B12	% deposits rec. from:									
	Individuals	36-100% (Ave:74%)	20-100% (Ave: 80%)	100%	100%		80-100%	100%	55%	0-100%
	MSMES	3%	0-80%			19%?	10-60%		5%	0%
	Poor HH		1%				3-35%		40%	30-100%
	Rural areas	30%	5-20%				71-100%	100%	85%	70-100%
B13	% deposits intermediated	40-83% (Ave: 61%)	60-100% (Ave: 81%)	100%		15%?	80-100%	100%	95%	50-100%

	Banks:			NBFIs:		Coops:		MFPs			
	Credit Services	SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-formals	
C1	<i>Outreach</i>										
	# consumer loans	42,393 (2)	127770	533 (1)				990		14937	
	Value consumer loans										
	Ave. loan size										
	# Mortgage loans	51,418 (2)	17,526	29				4675		CEP	
	Value mortgage loans										
	Ave loan size										
# (M)SME loans	24,317 (2)	4,828	126				2557			1562	
value (M)SME loans											
Ave loan size											
# loans to poor	50,939 (2)	667 (4)	30					1239	4125000	87485	
Value poverty loans									\$ 1.15 bn		
Ave loan size									\$337.50		
Other loans:											
Credit cards	51600 (1)	8026 (3)	37								
Leases						1494					
Group loans								0		1877	
Value, total loans						1.15 bn		\$ 9.8 mn	\$ 3.1 mn	\$ 17.1 mn	
Ave. loan size						\$72,300		\$1,100	\$193	\$114	
<i>Accessibility</i>											
C3	Receipt of application		Any branch, over phone (3)	Any branch		Any branch		Branch	HO	Branch	Branch/center
C4	Point of processing	Any outlet	Any branch	Any branch		Any branch		HO	HO/non-branch		Branch/center
C21	Processing time	1-20 days	3-30 days	7-21 days		15-25 days		1-7 days	1-5 days	5-15 days	7-30 days

		Banks:		NBFIs:		Coops:		MFPs		
Type of Respondent:		SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-formals
C5	Range consumer loans	VND 2-100 mn	VND 1mn - 1 bn	\$ 3-3.75 mn			V 100,000-130 mn	VND 100,000-8 mn	VND 10 mn	VND 100,000-1.3 mn
C7	Collateral %	50-100%	70-200%	50-100%			Y for 16% of resp.	80-100%	0	0
C10	Collateral type	Immovables	Also movables and guarantees	Also moveables			Equipment, land	Immovables, guarantees	none	None
C26/27	Int. rate p.a.	9.5-13.5%	9-15%	8-13%			9-17.4%, ave 9%	9.60%	7.80%	9.6-12.2%
C5	Range (M)SME loans	VND 100mn -30bn or max 85% of project	VND 11mn - 158bn or 85% of project	\$ 3-3.75 mn		10mn - 46.5 bn	1mn - 180 mn	1mn -30mn	max. 10 mn	max. 10 mn
C7	Collateral %	70-100%	70-167%	50-100%		70-100%	Y for 21% of resp.	80-100%	0	Y (1) 50%
C10	Collateral type	Immovables	Also movables and guarantees	Also moveables		equipment, house	Equipment, land	Immovables, guarantees	None	LUC, guarantees
C26/27	Int. rate p.a.	8.5-12.9%	10-15.6%	8-13%		10.8 - 12.6%	9.6-17.4%, ave 14.3%	9.6-14.4%	9.60%	24%
C5	Range mortgage loans	VND 10 mn - 120 bn or max 75% of asset	5mn - 158 bn or 85% of value	\$ 3-3.75 mn			VND 1mn - 300 mn	VND 1mn - 70mn	max. 200 mn	max. VND 15 mn
C7	Collateral %	70-100%	70-167%	50-100%			Y for 29% of resp	80-100%	100%	0
C10	Collateral type	Immovables	Also movables and guarantees	Also moveables			Equipment, land	Immovables, guarantees	Immovables, equipment	None
C26/27	Int rate p.a.	8.5-12.9%	11.4-15.6%	8-13%			9.6-16.2%, ave 14.9%	9.6-12%	7.80%	14.40%
C5	Range poverty loans	VND 5-20 mn	VND 1mn - 50 mn	0			VND 500,000 - 9 mn	V 500,000-8mn	max. 15 mn	VND 285,000-15mn.
C7	Collateral %	0	70-100%				Y for 8% of resp	50%	0	0
C10	Collateral type	0	Also movables, savings, guarantees				Equipment, land, livestock	Guarantees	None	None
C26/27	Int rate p.a.	11.40%	11.4-15.6%				8.4-16.2%, ave 12.9%	12%	7.80%	11.25-24%
C5	Range Group loans	0							max. 500 mn	475,000-9.5mn
C7	Collateral %	0							100%	Y (1) 50%
C10	Collateral type	0							Immovables, equipment	LUC, house, guarantees
C26/27	Int. rate p.a.	0							7.80%	10.32%
C24	% applic. rejected	2-30%	10-25%	1%		2-30%	5-50%, 3 reject all poor	5-50%	10%	0.5-15%
	Reasons why	poor business plans, limited repayment capacity, no collateral	Limited project feasibility, repayment concerns	Lack of repayment capacity		Project not feasible	Unconvincing business, repayment cap.	project not feasible, non-member, credit rationing	Not targeted client	Group Membership, unclear purpose, other loans
Developing a Comprehensive Strategy to Access to Micro Finance										120

		Banks:			NBFIs:		Coops:		MFPs	
Type of Respondent:		SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-formals
Other Services										
D1	Remittances offered	Y	Y	Y	Y	Y (1)	N	N	Y	N
D2	Cost to customer	0.02-0.07% of value	0.025-0.07%	0.012-0.05%	0.05%	0.02%				
D5	Check books	Y	Y	Y	N	N	N	N	Y	Y (1)
D5i	Cost to customer	VND 580	VND 600-10,000	VND 3200-10000			N		VND 500	
D6	ATM /debit cards	Y	Y (8)	Y (1)	N	N	N	Y (1)	N	Y (1)
D8	Payment of utility bills	Y	Y (11)	Y (2)			N	Y (1)	N	N
E1	Life Insurance	N	Y (1 w/ Manu)	N			N	Y (1)	N	Y (1)
	Non-life insurance	Y (1)	Y (2)	N	Y	N	N	Y (1)	N	N
	Credit insurance	N	N, 1 considers	N			N	N	N	Y (1)
E2	Cost as % of value	0.15%	0.03%, min. 250,000		VND 26,000/yr					VND 200/w
Portfolio and Financial Performance										
F1	% of respondents w. automated MIS	60%	27%	50%	N	50%	8.30%	0%	N	11%
	% of respondents with automated Accounts	80%	33%	0	Y	66%	8.30%	0%	N	22%
Asset quality										
F2i	NPL/Bad debt ratio	0.66-10% (Ave:4%)	0.29-3.6% (Ave:0.9%)	0.81%	0	0-9.08%	0.001-2.24%	0.3-3%	2.10%	
F2ii	Arrears ratio	1.88-3.3% (Ave: 3%)	0.29-4.4% (Ave 1.4%)	1.16%	0	2.4-27.5%	0.08-3%	0.5-15%	3.40%	0.012-3.08%
F2iii	Portfolio at Risk ratio		1% (1)			20.90%	0.016-3%	0.5-15%	3.70%	0.03%
	LAR		0.5-3.15% (3)	1.31%		55.20%				0.089-3.08%
Efficiency										
F3i	OER I (ave. gross loan portfolio)	0.14-53% (median 1.65%)		5.67%	7.30%	9.4-10.9%	9.6-13.2%			19.7-39.8%
F3ii	OER II (ave. total assets)	0.75-17%	1.4% (1)	3%		8.9-9.9%	9.3-11.8%			16.2-36.6%
	Cost per borrower	\$ 7.8 (1)		\$11,600?						VND 13-561
	Cost per saver/ savings account	\$ 6.8 (1)		\$13600?						Y
	Oper. Cost/tot. exp.		27.8% (1)							
	Tot exp/tot revenue							60%		
	No. active borrowers per branch	2200 (1)	543	194						938-3,151
Developing a Comprehensive Strategy to Access to Micro-Finance										
	Average number of savers/savings accounts per branch	15,000 (1)	1400	129	7,251					121
	Borrowers/Cos						341			131

		Banks:			NBFIs:		Coops:		MFPs	
Type of Respondent:		SOCBs	JSCBs	JVBs/FBs	VPSC	Leasing	PCFs	ACCs	VBSP	Semi-form
<i>Sustainability</i>										
F4	Return on Assets	0.35-1% (Ave 0.65%)	0.77-3.28% (ave 1.81)	1.89%	0.02%	0.01-1.49%	0.66-2.16%	0.1-6.2%		
	Return of Equity	7.95-14.9% (Ave 10%)	14.4-40.6% (Ave 20.5)	13.18%	1.01%	0.09-16.3%	1.18-9.18%	1-7.9%		
	Net interest margin	0.57-8.9% (Ave 4.75)	1.5-6% (Ave 4.06)	4.01%	0.09%	1.38%	0.72-2.62%			
	Portfolio yield	7.3-13% (Ave 9.6%)	10.9-15.8% (Ave 13)	6.42%						
	Profit/revenue (ROS)		15.06 % (1)							
	FSS	25% (1)	123.8% (1)	143% (1)			95-98%			
OSS	28-120%	133% (1)	155% (1)			112%	110-125%			

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