

MICROFINANCE INDUSTRY REPORT

Vietnam

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Produced by The Banking with the Poor Network in collaboration with the SEEP Network
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Foreword

This assessment was completed as a Banking with the Poor Network (BWTP Network) activity within the Citi Network Strengthening Program, in collaboration with the SEEP Network and funded by the Citi Foundation.

The Citi Network Strengthening Program supports the development of Industry Assessments for national and regional level networks. The purpose of the BWTP Network Industry Assessments is to provide an overview of the microfinance sectors in which the BWTP Network operates. These assessments aim to extend beyond the performance of individual institutions, and focus on the development of the microfinance market as a whole by being both descriptive and analytical in nature. The aim of these assessments is to provide an outlook on each industry that is a valuable resource to the BWTP Network, its members and the wider microfinance community.

The Vietnam Industry Assessment is a review of the microfinance sector in Vietnam, and constitutes a new contribution to the BWTP Network's Asia Resource Center for Microfinance. This assessment builds on a country profile completed by the BWTP Network in 2006. The Vietnam Industry Assessment is based on research conducted from a desk study, as well as contributions resulting from meetings with key stakeholders and practitioners in Vietnam in June and July 2008 in Vietnam.

The ARCM is based on dialogue and information exchange at national and regional levels in South and Southeast Asia, and aims to constitute a one-stop learning and information hub for BWTP members and other microfinance actors in Asia.

The ARCM promotes increased outreach and efficiency of financial services for the poor in South and Southeast Asia, services that are essential in the fight against poverty in the region, improving the lives of millions through asset building and increased income.

The ARCM has two main objectives:

- › First, the ARCM aims to encourage partnerships and cooperation in Asia, among microfinance providers and supporters, and between providers and financiers, in order to increase financial support for microfinance schemes and to increase peer learning.
- › Second, the ARCM aims to build a knowledge management platform accessible to all microfinance actors in the Asia region, in order to increase institutional capacity, to increase the dissemination of innovations, and to develop regional and sub-regional standards in microfinance.

Acknowledgements

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The Vietnam Industry Assessment is also the result of a close and productive collaboration between Ms Hansen and Ms Diaz, the BWTP Network, the Foundation for Development Cooperation, in-country partners and Vietnam microfinance industry stakeholders including the Vietnam Microfinance Working Group, the State Bank of Vietnam, the Vietnam Bank for Social Policies and M7. The BWTP Secretariat would like to thank all those who participated in its production.

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Acronyms and Abbreviations

- › **ADB** Asian Development Bank
- › **AFD** Agence Française de Développement
- › **BOP** Bottom of the Pyramid
- › **CCF** Central Credit Fund
- › **CEP** Capital Fund for Employment of the Poor
- › **CFRC** Community Finance Resource Center
- › **CIC** Credit Information Center
- › **CPRGS** Country Poverty Reduction and Growth Strategy
- › **DFID** Department for International Development (UK)
- › **DIV** Deposit Insurance of Viet Nam
- › **IFC** International Finance Corporation
- › **GoVN** Government of Viet Nam
- › **HEPR** Hunger Eradication and Poverty Reduction Program
- › **INGO** International Non-Governmental Organization
- › **JSCB** Joint Stock Commercial Bank
- › **LIH** Low Income Household
- › **LSS** Living Standards Survey
- › **LPC** Local People's Committee
- › **LUC** Land Use Certificate
- › **MO** Mass Organization
- › **MFI** Microfinance Institution – used for licensed, semi-formal providers
- › **MFO** Microfinance Organization – used in Viet Nam for unregulated providers
- › **MFWG** Microfinance Working Group
- › **MSE** Micro, small enterprises
- › **OSS** Operational Self-Sufficiency ratio (% of direct costs covered by revenue)
- › **PaR** Portfolio at Risk (% of portfolio 'contaminated' by arrears)
- › **PCF** Peoples Credit Fund
- › **RoA** Return on Assets
- › **RoE** Return on Equity
- › **SBV** State Bank of Viet Nam
- › **SCIC** State Capital Investment Corporation
- › **SME** Small and Medium Enterprises
- › **SOCB** State-owned Commercial Bank
- › **TYM** Tau Yeu May Fund
- › **VAPCF** The Viet Nam Association of People's Credit Funds
- › **VBARD** Viet Nam Bank for Agricultural and Rural Development
- › **VBSP** Viet Nam Bank of Social Policy
- › **VDB** Viet Nam Development Bank
- › **VPSC** Viet Nam Postal Savings Company
- › **VND** Vietnamese Dong
- › **VWU** Viet Nam Women's Union
- › **WB** World Bank

1. Country Overview

1.1 Geography

Viet Nam is located on the eastern margin of the Indochinese Peninsula and occupies some 331,688 km². The country is divided into the 'Highlands' and the Red River Delta in the north, the Gai Truong Son (Central Highlands), the coastal lowlands, and the Mekong River Delta in the South. It is prone to natural disasters including drought and cold in the North, floods in the deltas, and typhoons along the coast. The two largest cities are Ho Chi Minh City (3.14 million), and Hanoi (1.34 million). There are 59 provinces and five municipalities with a total of 671 districts subdivided into 10,876 communes¹.

1.2 Population and Demographics

In 2008, Viet Nam's population will surpass 86 million. According to the latest Living Standard Survey (2004), about 26% of the population is younger than 14 years and 6% are older than 65 years, hence the economically active population (15-64 year-olds) makes up 68.6% of the population, or 59 million people, of whom 50.8% are women².

The population density varies considerably in Viet Nam. It is lowest in the northern highlands, at around 68 persons per km², while the two river deltas are the highest. The Red River Delta has over 1,225 people per km². Most Vietnamese live in rural areas, but the rapid economic growth over the past 10 years has resulted in significant rural-to-urban migration. Around 72.5% of the population lives in rural areas today³.

The majority ethnic groups of Kinh (Viet) make up 86% of the total population while 14% are from the 53 small, heterogeneous ethnic groups, of whom the largest are the Tay and Muong⁴. These ethnic minorities, however, remain vastly over-represented on the poverty map of the country.



1.2.1 Poverty

Viet Nam is a success story for drastically reducing poverty rates. From 1993 to 2006, 42% of the population, or 35 million people, were lifted out of poverty, reducing the percentage of people living under the national poverty line from 58% to 16%.⁵

By the end of 2007, the poverty rate was reduced even further to 14.2%, and while this is impressive, it still leaves 12.3 million Vietnamese living in poverty.⁶

1 General Statistical Office of Viet Nam: Statistical Year Book of Viet Nam, 2007.

2 CIA World Fact 2008, 2008 estimates and GSO: Statistical Year Book of Viet Nam, 2007.

3 GSO: Statistical Year Book of Viet Nam, 2007.

4 Asian Development Bank: Ethnic Minorities and Poverty Reduction, June 2002.

5 World Bank. Viet Nam Development Report 2008.

6 In 2006, the national poverty line was set at VND 260,000 (US \$16) per month per person in urban areas and VND 200,000 (USD\$12) per person per month in rural areas.

Table 1. Population and Demographic Data, Viet Nam, 2000-08

	2000	2005	2006	2007	2008
Total Population (WDI/CIA 2008)	77.64m	83.10m	84.11m	85.2m	86.1m
Population growth (WDI/CIA 2008)	0.2	1.3	1.2	1.2	0.99%
Economically Active Population			69%	68.6%	68.6%
Adult literacy rates (HDR 2007) (1995-2005)	90.3%	90.3%	..	..	..
Life expectancy (WDI, 2008)	69	71	71	..	..
% of population below the national poverty line	19.5%	..	16%	14.2%	..
Population density (ADB 2007)	236	252	254	257	..
% of population in rural areas (ADB 2007/GSO)	75.8	73.1	72.88	70%	..
Human Development Index	..	..	..	0.733	..
Human Development Ranking (out of 177)	..	..	..	105	..

Sources: World Development Indicators (2008), Asian Development Bank (2007), Human Development Report (2007); GSO: Statistical Year Book of Viet Nam, 2007.

Most low-income households are in rural areas⁷ and are predominantly engaged in agricultural crop production and raising of small livestock, selling any surplus produce at the local markets. Most of these households⁸ (86%) have access to land. In addition to farming, at least 35% operate non-farm household businesses⁹. The improvement of physical infrastructure has contributed to the reduction of poverty. Similarly, access to irrigation, high-value crops (such as coffee, spices, shellfish or fish in addition to rice) and to a local market positively impacts income generation from both farm and non-farm activities.

7 IMF: Country Report 07/386 Viet Nam, Statistical Appendix, December 2007.

8 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.

9 World Bank: Viet Nam Development Report, 2004: Poverty.

The GDP per capita income has risen over the past few years, from \$410 in 2004 to \$835 in 2007. However, there is a large difference between the average per capita incomes of \$793/year for urban residents and the rural average per capita income of \$374/year (2006). Poverty is more strongly related to ethnicity than to geography and remoteness. In 2006, only 10% of Kinh and Chinese were poor, while 52% of ethnic minorities lived below the poverty line. Poverty is vastly more persistent in the northern mountains, Central Highlands, and along the flood-prone delta coastlines where ethnic minority residents live.

For the first time in 13 years, urban poverty is not declining. Currently, migrant workers receive lower wages, lack access to social protections such as health care, and their children cannot access education without resident certificates.

The recent price hikes of food and oil, and the boom in real estate prices, do not bode well for the poverty situation in urban areas over the next few years, when rural-urban migration is expected to reach 1 million people annually¹⁰. The main reasons for Viet Nam's huge success in poverty reduction are government policies to distribute agricultural land to rural households and support for the integration of agriculture into the market economy, while job creation in the private sector has been promoted as part of the overall economic reforms since 1986. The goal set by the Ministry of Labor, Invalids, and Social Affairs (MOLISA) for 2008 is to focus on the 58 districts where poverty rates exceed 50% of the population, and to reduce the overall household poverty rate to 12%¹¹.

1.2.2 Labor and Employment

The labor force of Viet Nam is estimated at 51.87 million people¹² and the agriculture sector continues to employ the highest percentage of workers. (The rate has slowly declined from 64% of the labor force in 2000 to 54% in 2007.) As the engine of economic growth, the private sector is generating increasing employment in the growing manufacturing and service sectors, including trade, finance and a booming tourist sector. With decreasing rates of infant mortality and increasing life spans, key demographic challenges for the country will be the continuing creation of jobs for the 1.6 million young people entering the work force every year, increasing the supply of skilled labor, and the generation of resources to care for an aging population.

With massive economic growth in recent years, Viet Nam has an overall low unemployment rate. From 2000 to 2005, unemployment steadily declined to the current 2.1% of the economically active population, highest in the urban areas of the Red River Delta at 5.74%. In real numbers, 1.24 million Vietnamese were unemployed in 2007¹³.

10 World Bank: Viet Nam Development Report 2008: Social Protection.

11 Viet Nam development Focus: Poverty Alleviation. <http://www.VietNamgateway.org/focus>

12 GSO: Statistical Year Book of Viet Nam, 2007.

13 GSO: Statistical Year Book of Viet Nam, 2007.

1.3 Macroeconomic Conditions and Economic Performance

Viet Nam is in its third consecutive year of 8%-plus growth. The economic performance has relied on strong performance from industry, construction, services and trade, where growth rates have been between 8.3% and 10.4%. Integration with the world economy has strengthened significantly with exports accounting for 71% of GDP in 2005, up from 56% in 2001, and private sector employment grew five-fold over the same period. Agricultural sector growth slowed due to a number of natural catastrophes - including drought in the North, floods in the north-central region and Mekong River Delta, and pests in the South - but still maintained an annual growth rate of 3.5%. The transition to a market-led economy is evidenced by an increase in the share of domestic private investment in total investment rising from 23% in 2001 to over 32% in 2005¹⁴.

The business climate continued to improve after accession to the World Trade Organization (WTO) in January 2007, with total investments increasing to 40.4% of GDP. Foreign direct investment almost doubled to \$20.3 billion, and the domestic private sector increased by 59,000 new enterprises registered, 26% more than in 2006.

This consistent high growth led to large increases in credit, stock market activity, and consumption, especially of imported goods, and in 2007 Viet Nam's economy began to show signs of overheating. The stock market boom in the first half of 2007 was curbed by State Bank intervention to cap lending for purchase of securities, but the investment surge moved to the real estate market, causing an unprecedented price hike. As Viet Nam is a major food exporter (rice) and exports as much crude oil as it imports gasoline, the country as a whole benefits from the increasing world market prices. Along with the global price increases in food and oil, however, the currency (Dong) was appreciating and inflation accelerated from 6.6% in December 2006 to 18.3% by March 2008.

14 World Bank: Country Assistance Strategy, 2007-2011.

Table 2. Labor Market Data, Viet Nam, 2000-2007

	2000	2004	2005	2006	2007
Labor force (GSO 2007)	37.6m	41.6m	42.5m	43.3m	44.2m
By occupation in:					
Agriculture			55.6%		54.2%
Industry			18.9%		19.5%
Services			25.4%		25.5%
Labor force by sector:	100%	100%	100%	100%	100%
State	9.3%	9.9%	9.5%	9.2%	9%
Private	90.1%	88.6%	88.9%	89.2%	89.4%
Foreign companies	0.6%	1.5%	1.6%	1.6%	1.6%
Unemployed	0.9 m	0.9 m	1.1 m	..	1.2 m
Unemployment Rate	2.3	2.1/5.6	2.1/5.3	..	..

Data Sources: Key Indicators of Developing Asian and Pacific Countries, ADB, 2007; ADB Development outlook; GSO: Statistical Year Book of Viet Nam, 2007.

Table 3. Macro-economic Developments

	2004	2005	2006	2007E	2008 F
GDP current billion \$ (WDI/CS)	31.17	53.10	61.00	71.2	90.1
Real GDP Growth (%)	7.8	8.4	8.2	8.5	7.5
Real GDP per capita income (US\$) (GSO)	\$401	\$639	\$723	\$835	1,043
GNI per capital (US\$)				\$ 690	
Inflation rate, GDP deflator (annual %)	3.4	8.2	7.3	12.63	18.1 ¹
FDI net inflow (US\$ million) (WDI/CS)	1,298	1,954	2,315	6,550	12,000
Current account balance, % of GDP	-3.8	-1.5	-0.8	-9.9	-10.3
Fiscal deficit, % of GDP	2.8	-0.8	-0.9	-0.7	-0.5
ODA, US\$ millions (WDI, 2008)	1,681	1,907	1,845	..	..
Average exchange rate \$ (ABD 2008)	15,741	15,859	15,994	15,995	..

Data Sources: World Development Indicators, 2008 International Monetary Fund (2007), Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 2007, ADB: Asian Development Outlook 2008; GSO: Statistical year Book of Viet Nam 2007; Credit Suisse Research.

With rapid growth remaining a priority, it took time for the Government to react to the overheating economy. But by February 2008, a shift in priorities toward macro-economic stability seemed to have taken hold with a policy mix of fiscal, monetary, and exchange rate measures being enforced to try to stem the credit-led investment frenzy, control inflation, and ensure financial market stability.

In other words, to cool the economy¹⁵. Viet Nam's economy is resilient and GDP growth rates of 7.4% in March 2008 against the announced annual target of 7% would suggest that stabilization measures can continue to be given priority¹⁶.

15 World Bank: East Asia and Pacific Update – Testing Times Ahead, April 2008.

16 World Bank: Taking Stock, June 2008.

2. Financial Sector Overview

The formal financial sector in the country is supervised by the State Bank of Viet Nam (SBV), which has branches in all 59 provinces and five municipalities and regulates and supervises banks, non-bank financial institutions, and the regulated financial cooperatives, 'People's Credit Funds (PCFs)'. SBV operates the Credit Information Center (CIC), functioning similarly to publicly-owned credit reference bureaux elsewhere. Supporting the regulator is the Deposit Insurance of Viet Nam (DIV), which issues deposit certificates to financial institutions and manages liquidation of failed banks and PCFs¹⁷.

2.1 The Main Players

A diverse range of banks provide wholesale and retail banking services to different market segments, namely state-owned, urban and rural joint stock, joint venture, and foreign banks. The four main state-owned commercial banks (SOCBs) dominate the sector. In addition, there are 37 joint stock commercial banks (JSCBs), which account for roughly 15% of total assets, five joint venture banks (JVBs), and 28 foreign-owned banks with 39 branches.¹⁸ From 2003 to 2006, the number of banks increased from 69 to 80, but the number of joint stock banks has been consolidated from 54 to 37 through mergers and acquisitions.

In the initial stages of Viet Nam's economic transition, individuals did not use the banking system to any large extent. In 1993, only 25% came from banks and other formal sources¹⁹. Until 2004, Viet Nam had rather shallow financial depth. However, by 2007 that depth had increased sharply, with indicators such as the credit/GDP ratio reaching 82.5%, and M2/GDP rising to 112.1% from a base of 23.8% in 1996²⁰. Of this, credit to the private sector increased from 18% in 1992 to 68.6% in March 2007²¹.

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

18 State Bank of Viet Nam: 2004 Annual Report.

19 1993 Viet Nam Living Standards Survey (VLSS) quoted in Viet Nam Development Report 2006: Business.

20 ADBI: Managing Capital Inflows: the Case of Viet Nam, May 2008.

21 IMF: Viet Nam Country Report 07/386, Statistical Appendix, December 2007.

Reforms are continuing to transform ("equitize" or privatize) SOCBs to a more commercially sound footing. These SOCBs have improved operations and have strengthened their balance sheets over the past five years, but an estimated average rate of 8-10% non-performing loans will require significant provisioning as they undergo equitization over the coming three years. The government has already invested \$635 million to recapitalize the banks and offset losses²² (from 2001-05).

With initial support from CIDA, the network of People's Credit Funds (PCFs) were established in 1993 under a Prime-ministerial decision. PCFs are community-based financial cooperatives that are owned, operated, and governed by shareholding members, modeled after the Desjardins (caisses populaires) in Quebec, Canada. PCFs are licensed under the Cooperative Law, regulated by the Law on Credit Institutions, and supervised by the SBV under the Banking Law on their adherence to set standards regarding financial management and member capacity. In 2007, SBV granted business licenses to 50 new PCFs, and as of December 2007, there were 982 PCFs operating in 56 provinces and cities. A central apex institution, the Central People's Credit Fund (CCF), was formed in 1995. CCF, which may soon receive a name change to the Cooperative Bank, attracts and mobilizes capital from shareholders (the PCFs and the four SOCBs), donors and public deposits, serves commercial and urban customers from its 54 branches and supervises/intermediates funds to the local PCFs. Like VBARD and VBSP, the CCF is regulated by the Credit Institution Law and is supervised by the SBV²³.

Policy lending is a key feature of Viet Nam's financial sector. The Viet Nam Bank for Social Policy (VBSP) is mandated to serve the poor and other beneficiaries of government support. The Viet Nam Development Bank (VDB) serves primarily government projects, state-owned enterprises and, to a small extent (and with the support of international donors), private SMEs in the infrastructure and export sectors. Both

22 World Bank: Country program Strategy 2007-2011. Some analysts believe the NPL of the SOCBs is even larger at 15-30% as per Federal Reserve Bank of San Francisco: Asia Focus, February 2008.

23 World Bank: Taking stock, 2006.

Table 4. Formal Financial Sector Providers in Viet Nam at a Glance

Type of Institution	#	Names
State-owned Commercial Banks (SOCBs)	4	VietcomBank, VietInBank, BIVD, and the largest bank in Viet Nam: Viet Nam Bank for Agriculture and Rural Development (VBARD or AgriBank).
Joint Stock Commercial Banks (JSCBs)	37	Asian Commercial Bank (ACB), Sacombank and Techcombank hold about a third of total JSCB assets ² .
Joint Venture Banks (JVBs)	5	VinaSiam, Viet Nam-Laos JV Bank and others
Foreign owned Banks	28	Citi, ANZ, HSBC among many others
Cooperatives	982	People's Credit Funds and their apex the Central Credit Fund
Policy Lending Banks	2	Viet Nam Bank for Social Policy (VBSP) and Viet Nam Development Bank (VDB)
Non-Bank Financial Institutions	55	Viet Nam Postal Savings Company (VPSC), 5 sectoral financing companies, 12 leasing companies and 37 insurance companies.

lend on subsidized and non-market terms. VBSP and VDB are regulated by SBV and other government agencies under their own specific decrees and are the main vehicles for government transfers.

Non-Bank Financial Institutions include the Viet Nam Postal Savings Company (VPSC), five other 'sectoral' financing companies with limited banking licenses, a growing insurance sector, and 12 leasing companies affiliated with SOCBs or foreign banks.

Viet Nam's banking sector is often considered both heavily fragmented and concentrated, and the supply market is indeed crowded and complex. Fragmentation is caused by certain banks being assigned to specific market segments. VBARD, for example, is assigned to the rural and agricultural sector. This has, to a certain extent, restrained risk-sharing within the banking system and has narrowed the borrowing choices of businesses. Concentration is evident from the fact that the four dominant (and one smaller) State-owned Commercial Banks (SOCBs) account for about 70% of total assets, and 65% of total credit and deposits. The difficulties of the transition from a state-controlled to an open, market-led economy are still apparent in the institutional structure of the sector, although credit and deposit services have increased to all-time highs.

The financial depth of the formal financial sector and the existence of policy lenders mean that there is no clear market delineation between the formal banking sector and the microfinance market. The constraints related to fragmentation, concentration, the existence of subsidized policy lenders, and interest rate controls are affecting the entire financial sector.

2.2 Credit Services

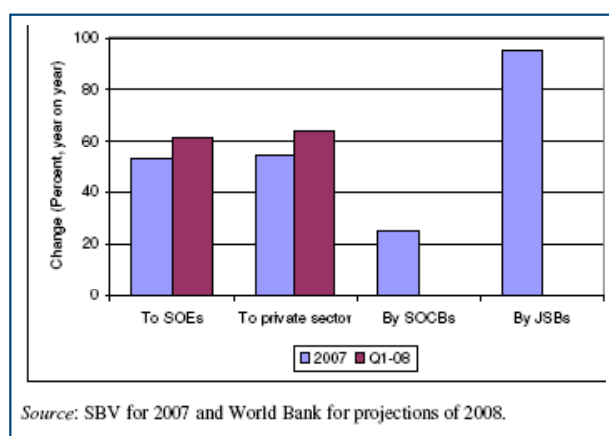
Overall credit grew by 50.6% from 2006 to 2007, well above the 30% target set by the government. In that period, 65.3% of all credit extended by the SOCBs and 82.5% of credit provided by other banks were for the private sector²⁴. SOCB credit increased by a restrained 25% partly due to preparation for equitization. JSCBs, on the other hand, expanded credit by an astounding 95% from 2006 to 2007 in an attempt to gain market shares in their core market of private companies, households, and individuals. Private sector loans accounted for 77% of the total JSCB loans outstanding (2007) and were provided as consumer loans (35%) and commercial loans to SMEs.

²⁴ IMF: Viet Nam Country Report 07/386 Statistical Appendix, December 2007.

For many of the JSCBs, however, the average loan size per customer exceeded VND 600 million (2006), indicating that they do not in general serve the lower income segment.

While several JSCBs are backed by credible foreign partners, others have much less risk management capabilities, which raises concerns about credit quality especially as many smaller JSCBs have invested heavily in stocks and real estate. Stock markets lost dramatically in 2007 and the real estate bubble may lead to eventual losses there too. It is estimated that 10% of all bank loans in early 2008 were for real estate, compared to 3% a year before²⁵.

Figure 5. Recent Credit growth



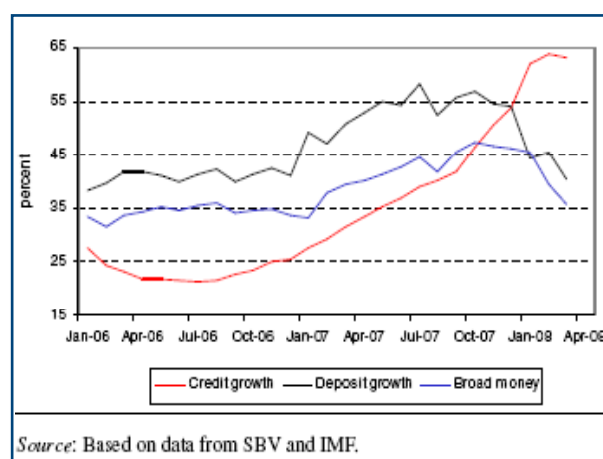
VBARD is the dominant provider of rural financial services. It does not directly target the poor, but serves poorer segments of the population through targeted programs capitalized by donor funds and through framework agreements with 'Mass Organizations', particularly the Farmers' and Women's Unions. SMEs are also an important market segment for SOCBs and the urban joint-stock banks.

25 World Bank: Taking Stock, 2008. See also GS Economic Research Website: Asia Economics Flash, May 2008.

2.3 Savings Services

Formal financial intermediation has increased rapidly in Viet Nam, if not at the frenetic pace of credit. Confidence in the banking system has grown, as evidenced by the growth in deposits from 43% of GDP in 2000 to 82% in 2006.²⁶ Recently, however, this confidence has been shaken by the near-crash of the stock exchanges and the increase in prices and inflation, and deposits have dipped during the past year (see Figure 9). Interestingly, deposits in gold have increased and banks such as VBARD are accepting increasing gold deposits from customers.

Figure 6. Growth of credit, deposits, and broad money²⁷



Based on a rough estimate, there are about 25 million active voluntary savings accounts provided by formal financial institutions (2006), which is more than the total number of households in the country²⁸. This represents a total of \$49.9 billion in deposits (2006). However, most of the savings accounts are current or short-term, and Viet Nam still needs to mobilize more domestic long-term financing to reduce the mismatch between deposits and loans in order for banks to provide longer-term loans as demanded among enterprises and to meet the ambitious growth target of 40% of GDP (or US\$140 billion) from 2006 to 2011²⁹.

26 IFC, Financial Sector Diagnostic, 2007.

27 Courtesy of World Bank: Taking Stock, June 2008.

28 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.

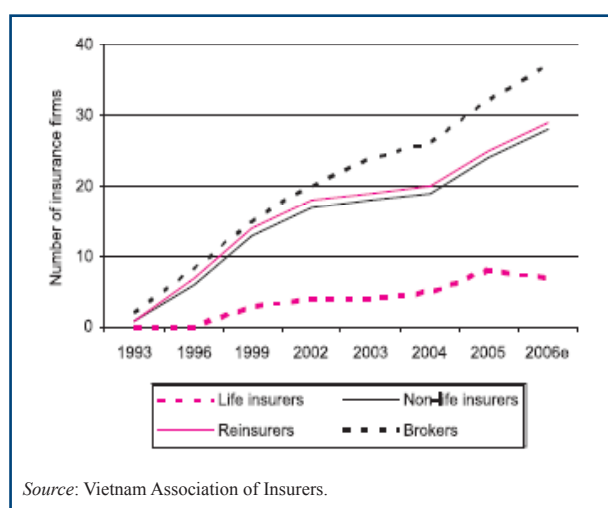
29 World Bank: Financial Market Infrastructure Development Project Information Document, November 2007.

2.4 Other Financial Services

Remittances form an important part of Viet Nam's financial landscape as inflows primarily from overseas Vietnamese and laborers abroad. Private remittances are estimated to reach over \$6 billion in 2007, almost as much as Foreign Direct Investment inflows³⁰. Remittances are generally channeled through the formal financial system and transfer services are available from most regulated financial service providers either directly or through agent arrangements with specialized providers such as Western Union and MoneyGram.

Social insurance and protection programs have been a focus area for the government over many years as well, and health insurance as well as pension schemes are available to low-income households. However, overall insurance penetration rate is lower in Viet Nam than elsewhere in the region with more than 90% of the population not having any formal insurance policy.³¹ The private sector 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.

Figure 7. Growth of insurance products



Starting from a very low base, growth rates are impressive. By the end of 2006, there were 37 firms of various legal form and scale operating in the

30 World Bank, Taking Stock, June 2008.

31 Mark V.T. Saunders and Adrian Liu: Life Insurance 2/2006: "Viet Nam: A New Star in the East".

regulated life and non-life insurance, reinsurance, and insurance brokerage sectors. Of these, three were fully state-owned (Bao Viet, Bao Minh, and Petro Viet Nam), 16 were joint stock companies, four were joint ventures and the remaining 14 were fully private³²

The life insurance market started only in 1996 when the state-owned Bao Viet insurance monopoly was converted into the Viet Nam Insurance Corporation. 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. Combined life insurance products with savings and investment elements have accounted for a good part of the growth, but with the competition from the banks and stock market heating up in 2007, this alternative to long-term savings instruments has come under pressure. The non-life insurance market (property and assets, fire and health) grew 25% year-on-year in 2006, totaling sales of \$189 million. Viet Nam has 15 domestic companies selling non-life insurance, but Bao Viet (32% of total premium sales) and Bao Minh (24%) also dominate the non-life market.

2.5 Access to Finance by the Bottom of the Pyramid (BOP)

There is consensus that the traditional market for microfinance services in Viet Nam constitutes 24 million poor and low income people, or 5.4 million low-income households (LIHs) at the bottom of the economic pyramid (BOP). Among the poor, and in rural areas, VBSP, some PCFs and the semi-formal microfinance organizations constitute the main providers of credit, complemented to some extent by the directed credit channeled through VBARD and a vibrant, informal system of credit providers or traders, local shops, money lenders, and savings- and credit groups, of which many have developed in collaboration with socio-political 'Mass

32 World Bank: Viet Nam Development Report 2008 Social Protection, June 2008, from where the figure is also taken.

Organizations'. Even with a relatively aggressive adjustment for double counting, it appears that these financial service providers together may provide credit to some 6.11 million borrowers, exceeding by 12% the total estimated number of LIHs in the country³³.

One quarter of Kinh and Chinese took loans from formal financial providers in 2006, with VBARD being their primary lender.³⁴ The poorest communities, chiefly ethnic minorities, however, are also reached by credit providers, with one-third of minority households borrowing from formal sources (see Figure 8). Among the ethnic minorities, 58% of all loans and 70% of all resources borrowed stem from the formal financial sector, VBSP being the dominant source (33% of all credit).

Figure 8. Access to Credit by ethnicity in Viet Nam

Lenders	Percent of households borrowing from the different lenders		Percent of resources borrowed from the different lenders			
	2006		2004		2006	
	Kinh and Chinese	Ethnic minorities	Kinh and Chinese	Ethnic minorities	Kinh and Chinese	Ethnic minorities
Formal	25	36	61	68	70	69
VBSP	7	18	3	16	5	30
VBARD	17	18	42	51	47	38
Other banks	2	0	17	1	18	0
Informal	21	23	39	31	30	31
Employment support fund	1	1	1	0	0	1
Credit organization	2	1	4	2	4	6
Mass organization	3	3	1	3	2	4
Money lenders	4	5	6	5	4	5
Friends and relatives	12	13	25	19	19	13
Others	1	2	2	3	1	2
Total	41	54	100	100	100	100

Source: Based on data from GSO. Data for 2006 are preliminary. The total is not sum of formal and informal borrowing because a household can borrow from more than one lender.

Recent indications suggest that VBSP may be evolving into a bank for ethnic minorities. While this may be a short-term solution to access to finance for these communities, the crowding out of the more commercially oriented VBARD may make it difficult for the poorest to graduate to mainstream finance in the future unless the transformation is accompanied by a long-overdue

33 The MIX: "How many MFIs and Clients are there" in Deutsche Bank Research Current Issues

34 World Bank: Viet Nam Development Report 2008 – Social protection, June 2008, from where the figure is also taken.

decision to commercialize VBSP, allowing it to operate as a sustainable bank. Alternatively, the further specialization of VBSP as a lender exclusively catering to the poorest of the poor in Viet Nam would free up competitive space for more sustainable financial service providers in the rest of the traditional microfinance market.

As documented by numerous financial sector reports, most poor and low-income households have access to some form of credit, and 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. Unfortunately, most providers are relatively supply-driven and have

not markedly adjusted products and services to changing needs among their clientele. Therefore, customers generally appear to compose a suitable package of financial services for themselves from multiple sources, and multiple borrowing is widespread – and largely undetected due to a lack of credit reference systems and information sharing among microfinance providers.

For most microfinance clients, therefore, access to any credit is no longer as much of an issue as is a loan that properly suits their needs. There is an increasingly sophisticated demand for larger and differently structured loans. Rather than traditional outreach to cover a

very large unmet demand for financial services, the challenge for successful microfinance in Viet Nam is thus the provision of specialized services to poor entrepreneurs and households in more remote areas, and the identification and retention of relatively poorer clients in more accessible areas in direct competition with supply-driven and subsidized policy lenders and increasingly commercial banks.

The availability of liquid, small-balance savings products that poor people generally demand is more limited than credit in the policy-driven microfinance market in Viet Nam. The relatively extensive branch network of VBARD, VPSC via the post offices, VBSP and the growing PCF network does in principle ensure access by most BOP households to formal sector savings services in proximity to their residences. However, as assigned banks, both VBSP and VPSC are required to transfer mobilized voluntary savings to other government investment vehicles such as VDB, or face deductions in their government funding budgets, and hence their motivation to expand savings services is limited. VBARD, as a more commercial bank, prefers larger and longer-term deposits, and thus does not offer many savings products that are suitable for the poor. MFOs remain barred from intermediating voluntary savings until Decree 28/165 comes into effect and they become licensed. With the transformation of the largest MFOs to deposit-mobilizing microfinance institutions under Decree 28/165, the supply of more sophisticated savings services to BOP may increase.

By all accounts, the demand for low-cost insurance services among BOP households is very high and largely unmet; on the demand-side, awareness is low and perceived pricing of premiums is higher than actual costs. On the supply-side, the potential size and profitability of the BOP market segment has only recently been recognized with the larger MFOs leading the way toward promising life, credit-life, and health insurance schemes.

Outside the traditional BOP market, demand for financial services is also created by small and medium enterprises, which play a key role in the economy.³⁵ As of 2006, Viet Nam had over 2.7 million registered businesses, of which 90% were classified as micro-, small and medium-sized enterprises (MSMEs).³⁶

35 SMEs were officially recognized and authorized by Government Decree 90/2001/ND-CP in November 2001 to include state-owned, private, and cooperative businesses as well as 'business households'. The decree also established an SME Department under the Ministry of Planning and Investment, and a SME Development Plan for 2006-2010 was been approved in 2006.

36 IFC, Financial Sector Diagnostic, 2007.

Table 9. Enterprise delineation

Enterprise type	# of employees	Assets/Sales
Micro/individual	0-9	Monthly revenue of VND 6-40 million (USD 375-2,500)
Small and Medium-sized	10-299	Max. VND 10 billion (\$625,000)

Businesses in this sector, the engine for economic growth in Viet Nam, 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.³⁷ This appears to be a contradiction because the Vietnamese financial market has expanded at a frenetic pace over the past years and credit to the private sector reached 82.5% of GDP in 2007. The explanation relates to credit allocation: as presented above, very small loans (up to VND 30 million or US\$1,875) are quite readily available to farmers and micro-businesses in large part because of government policies. However, slightly larger businesses (especially in urban areas, with the notable exception of clients of CEP in Ho Chi Minh City) and households that need credit but do not qualify as 'poor', face difficulties accessing credit and other financial services.

Formal credit providers are often reluctant to lend to micro and small enterprises (MSEs), or they require collateral that these businesses and low-income households are unable to provide. Heavy reliance on collateral is the flip side of the limited capacity for risk assessment by the dominant formal sector lenders³⁸. Delays in the issuance of land use certificates (LUCs), which can be used as collateral, have compounded the problem. The informal markets (money lenders) that are willing to offer finance to MSEs often lend at rates that may jeopardize the borrower's business³⁹.

37 World Bank: Doing Business. Viet Nam Country Profile/Survey, 2005.

38 Viet Nam Country Development Report 2006: Business.

39 UNDP: Human Development Report, 2004.

3. Regulations and Government Initiatives

3.1 Financial Sector Reforms

Since the inception of the Doi Moi (renewal) policy in 1986, the government of Viet Nam has been committed to financial sector reforms. The former mono-bank system in Viet Nam was delineated into a two-tier banking system in the late 1980s, but SBV is still the representative owner of the SOCBs. The Banking Law of 1990 and the new chart of accounts of SBV introduced in 1993 set the backdrop for a comprehensive reform program which gained momentum in 2000 with strong support from many donors. In 2003, the SBV adopted a revised and expanded reform strategy to reflect the Government's Socio-Economic Development Plan (SEDP) 2006-2010 for the entire financial sector. In addition, a comprehensive roadmap for banking sector reform was issued in May 2006⁴⁰ and expanded in 2007 to include development of the securities market.

A key step was to fundamentally re-write the Law on Credit Institutions and the Law on the SBV, and drafts of these new laws are now expected to be adopted by the National Assembly in November 2008, when draft laws on deposit insurance and banking supervision will also be presented.

40 Through Prime Ministerial Decision 112 in May, 2006

Leading the policy intervention to cool the economy, the Central Bank took dramatic, 'contractionary' measures in early 2008 in order to stop the appreciation of the Dong. The trading band for the dollar was widened and later foreign currency purchase was stopped altogether, and the frenetic pace of credit was curbed by increases in reserve requirements and forced placements of government bonds. Managing the strong inflows of foreign capital will remain a challenge, but it is hoped that the policy mix, if combined with greater exchange rate flexibility, can ensure continued growth and take some of the strain off the financial sector.

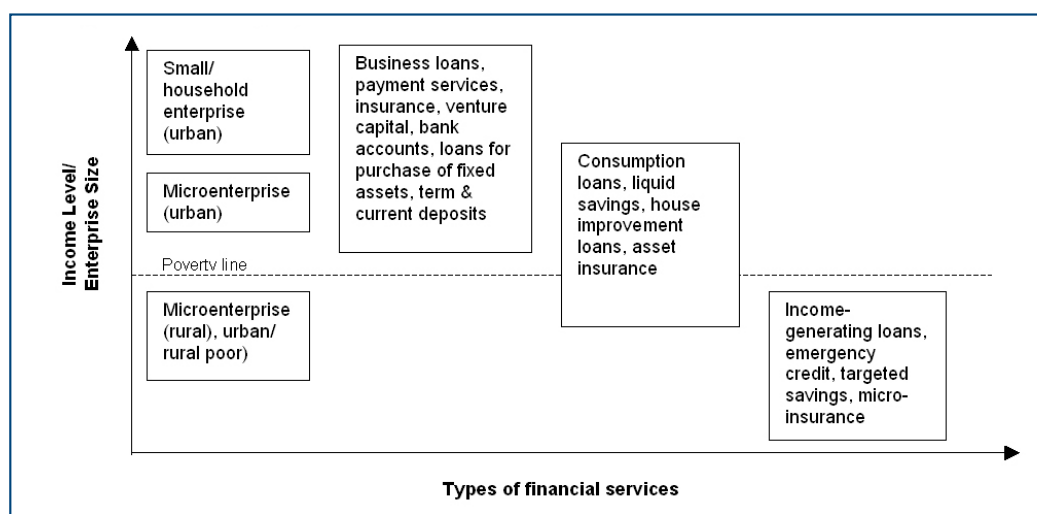
3.1.1 Price Setting

Since 2002,⁴¹ financial institutions have been free to negotiate their interest rates with their clients, but lending rates are still capped at a maximum of 150% of the prime rate published by the SBV to guide commercial lenders.

With the overheating in the economy resulting in inflation reaching 25% in May 2008, interest rates were raised sharply by the SBV to slow down credit growth. On May 18th, the prime interest rate was raised from 8.75% to 12% thus lifting the maximum

41 Decision 546/2002/QD-NHNN by the Governor SBV on May 30, 2002

Figure 10. Increasing Sophistication of the Demand for Financial Services¹



1 Mai Lan Le & Nhu An Trang: Entering a New Market: Commercial Banks and Small/Micro Enterprise Lending in Viet Nam, ILO Viet Nam Working Paper Series No. 3, 2003.

lending rate to 18%. In June 2008, the prime was then raised again to 14% providing a maximum lending rate of 21% p.a. It remains to be seen if this move will actually cool the frenetic credit market, but indications are that all commercial banks have hiked lending rates to the maximum.

The inter-bank lending rate (refinancing rate) has also increased to 18-21% for short-term loans. The decreasing liquidity in the market has caused banks to increase interest rates paid on deposits as well. SOCB deposit rates are now around 17-17.5% p.a. while some JSBs have increased deposit rates to 19%⁴².

Semi-formal MFOs, as well as future MFIs regulated under Decree 28/165 (see next section) will not be subject to the interest rate regulations.

3.2 Policy, Legal and Regulatory Framework for Microfinance

3.2.1 Microfinance Policy Framework

There is no national microfinance strategy in Viet Nam and the principles of sustainability underpinning 'Good Practice' microfinance are not widely embraced in the country's policy framework. However, there are indications that SBV is discussing a new project that will include a component to develop a national microfinance strategy in the near future. Nonetheless, microfinance is still widely seen as a social tool to combat poverty, and is different. It is therefore excluded from the normal workings of the financial sector. This social approach is reflected in general government policies for poverty reduction, and has introduced three particular distortions in the microfinance market:

- › The slow deregulation of interest rates through the SOCBs (see section 3.1.1) has implicitly limited the possibility of MFOs to set cost-covering interest rates.
- › The continued government funding of the Viet Nam Bank for Social Policy (VBSP), which

⁴² Communist Party of Viet Nam Online Newspaper: "Lending rate close to 21% per annum", 25 June 2008.

is mandated to provide supply-driven policy lending at unsustainably low interest rates, is tax-exempt and guaranteed by the government. The broad but non-market led outreach of this institution causes distortions in the entire financial system, and undermines sustainable microfinance. Its basic assumption that the poor are not able to afford market interest rates 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 than low interest rates loans provided by unsustainable institutions. There is no reason why Viet Nam should be different.

- › To date, the only legal basis on which to operate microfinance in Viet Nam has been a partnership with a 'socio-political' Mass Organization (MO), a local People's Committee, or a similar entity permitted by special authority to conduct financial services. MOs, with their broad social agenda, are well placed to facilitate mobilization of their poorest members, but have no reason to champion a more commercially oriented approach to microfinance, given the benefits of project funding, jobs and member services that microfinance partnerships have provided.

The absence of a coherent policy environment and of a commercially-oriented microfinance industry reflects the widespread perception of microfinance as a poverty reduction instrument. In many respects it also reflects the larger financial sector concerns and challenges in the transition to a liberalized market economy.

3.2.2 Legal and Regulatory Framework for Microfinance⁴³

Over the past three years, the State Bank of Viet Nam has released two Decrees (Nos. 28 and 165) and one circular relating to microfinance. This is viewed by stakeholders as an opportunity for the formalization of the microfinance industry.

⁴³ Text in this section is borrowed with permission from the author, Steven Pennings (Save the Children/US) from Decree 28/165 Workshop: highlights and selected issues, *Viet Nam Microfinance Working Group Bulletin, Issue 11, July 2008*

Table 11. Timeline of Decrees 28 and 165

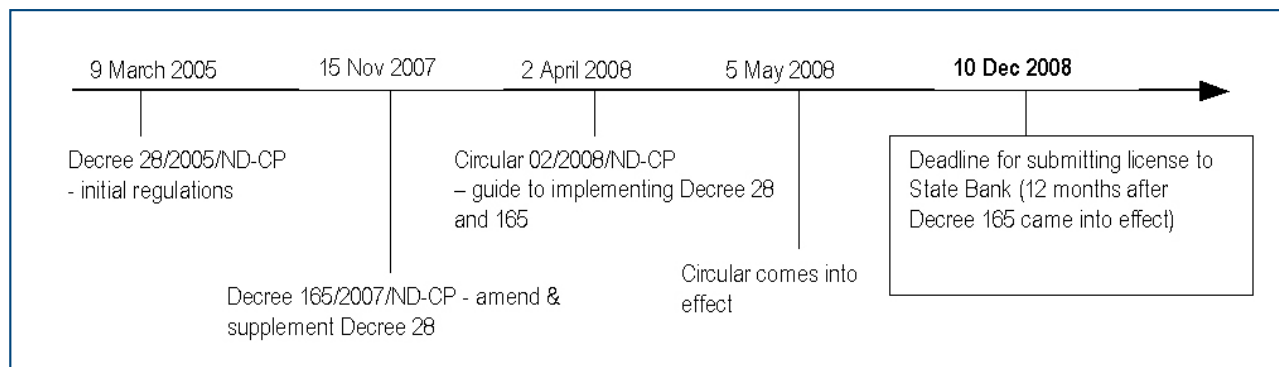


Table 12. Key revisions with Decree 165

Previously (Decree 28)	Today (Decree 165 & circulars)
Two levels of legal capital for MFIs: (a) To accept voluntary savings, required legal capital is $\geq 5bn$ VND (\$313,000) (b) Without accepting voluntary savings, required capital is $\geq 500m$ VND (\$31,250)	One level of legal capital: (a) To accept voluntary savings, required legal capital is $\geq 5bn$ VND (\$313,000)
If an MFO cannot be licensed, it has to shut down	If an MFO chooses not to be licensed, it can still operate so long as (i) it does not accept voluntary savings; and (ii) savings are less than 50% of equity

Table 13. Legal structure of Institutions licensed under Decree 28/165¹

Today (Decree 28/165 and circulars)	
One-owner Company	Multiple-owner Limited Company
MFIs must be wholly owned by a Vietnamese socio-political organization	Between two and five owners (except if authorized by the Governor of the SBV) Eligible owners: (A) socio-political organizations, (B) social organizations, (C) charities & Social Funds, ³ (D) vocational organizations (E) Vietnamese NGOs (Decree 88, 30/7/2003), local individuals, foreign individuals & organizations Owners A-E must own at least 25%, and must be the largest owners Foreign owners can have a maximum 50% share

Table 11 presents a timeline of the release of these decrees and circulars.

Issued in 2005, Decree 28 was initially meant to open a window for the strongest and largest microfinance organizations to transform into licensed Microfinance Institutions (MFIs), but it posed significant challenges to many stakeholders. The ownership structure was very restrictive and did not allow private-sector ownership. Instead, only mass organizations and local NGOs were allowed to “own” MFIs. Table 11. Timeline of Decrees 28 and 165

Without clear governance structures, access to commercial sources of funds would have been very difficult. Some smaller microfinance programs viewed the minimum legal capital requirement as too high and feared being shut down. Since mass organizations were supporting many of these smaller microfinance programs, their imminent closure created a difficult political dilemma.

In response to the debate in the industry, Decree 165/2007/ND-CP was approved on November 15, 2007 as a revision to Decree 28, and a Circular (02/2008/ND-CP) was issued on April 2, 2008 providing guidance to the implementation of the new Decree. The main revisions are summarized in Table 12.

The minimum legal capital for all types of MFIs is 5 billion VND (about US\$313,000). The minimum legal capital can be in the form of cash, fixed assets, or equity. For most existing microfinance organizations, equity from donations and retained earnings will be the main source of contributed capital. The maximum share that can be contributed as fixed assets (such as buildings) is 5% to ensure that MFIs have sufficient liquidity to operate.

The decree stipulates that the legal owners of the MFI equity must be the same as the owners/operators of the microfinance organization before licensing. In some cases, International NGOs have handed over the ownership of an existing MFO’s capital to a Local People’s Committee (LPC), but the local Women’s Union runs and ‘owns’ the MFO. In these cases (if the Women’s Union continues to

be the majority owner of the program), the LPC will have to transfer legal ownership of the capital to the Women’s Union. Generally speaking, the transfer of this capital before licensing is a matter between the owners and does not require State Bank approval.

3.2.3 Licensing Requirements: Operational Issues for MFIs

For an existing microfinance organization to be licensed as an MFI, the requirements of the Decrees and Circular include having professional staff as determined by the SBV, a business plan, audited financial statements⁴⁴, an organizational charter, and having consulted the local authorities by the due date of 10 December 2008. Some MFOs have expressed difficulties in providing a final charter or presenting ‘fit and proper’ management as per the requirements⁴⁵ within the short time frame. However, no delays will be granted to any of the licensing criteria in the decree, even for organizations working in remote areas where professional staff are difficult to find. It is possible to revise the charter, name, equity or other items after licensing, but these require explicit approval from the State Bank. Some changes, such as the opening of new branches, also require the approval of the local People’s Committee (in addition to having the required amount of capital).

The larger, more mature MFOs such as CEP and TYM, and others, are in the process of preparing for transformation. There is a general consensus that about six to 10 MFOs may have what it takes to transform within the deadline of the decree. The rest will be able to operate as non-deposit-taking microfinance institutions if they so chose, or can transform to social funds.⁴⁶

44 The Ministry of Finance issues a list of authorized auditors – MFOs should choose an auditor from this list. The MFI must have audited financial statements for the last three financial years before applying for a license.

45 For example, the CEO must have a university degree and at least 3 years of working experience as a manager in the finance sector. Board Members must comprise accounting, auditing and financial education at university level, expertise and/or experience. (Circular, 22.1-2)

46 Social Funds are regulated by Decree 177/1999/ND-CP of December 22, 1999 Promulgating the Regulation on Organization and Operation of the Social Funds and Charity Funds.

The SBV recognizes that currently many microfinance programs are owned/operated by the Women's Union at the commune, district, or provincial levels. However, for all such microfinance organizations, it is the Central Women's Union that must submit the application (dossier) for licensing, because only the Central Women's Union has legal status.

MFI's regulated under the decrees are not allowed to provide microinsurance themselves, but they are allowed to act as insurance agents for insurance companies (Circular, Article 55.4). Some existing MFOs, such as M7 Ninh Phuoc, are pursuing this model. Other MFOs with existing microinsurance products (such as TYM) are spinning off these operations into separate institutions.

All MFI's regulated by the decrees will have the right to borrow from local banks (e.g. VBARD) in Vietnamese Dong, and must negotiate the terms of the loan with the commercial bank themselves without relying on the State Bank for support or political influence. Licensed MFI's can also borrow from abroad in local and foreign currency like any other private enterprise, but this requires permission from the State Bank. Normally this is not overly strenuous: the MFI and its foreign partner need to register the loan with the SBV and have to abide by the decrees related to foreign currency transactions.⁴⁷ The access to foreign capital is a distinct incentive for licensing, as unregulated MFOs will not be able to borrow from abroad.⁴⁸

Table 14. Definition of licensed MFI's in Viet Nam

Microfinance Institution:

In order to be licensed as an MFI under Decree 28/165 a microfinance organization must meet several requirements:

- A. The charter capital must be at least 5bn VND.
- B. The portfolio of microfinance loans must be at least 65% of the Gross Loan Portfolio, where a microfinance loan is defined as a loan of less than 30m VND (US\$ 1,875) (Circular Chapter IV, Article 53.2)
- C. The portfolio at risk must be less than 5% of the Gross Loan Portfolio
- D. Prior to licensing, an MFO must document that it is able to cover its operational costs, (i.e. the operational self-sufficiency ratio must exceed 100%). This will be a challenge for several existing MFOs in Viet Nam.

⁴⁷ Decree 134/2005/NĐ-CP dated 1/11/2005 on foreign currency transactions, and Circular 09/2004/TT-NHNN dated 21/12/2004.

⁴⁸ In the current environment (pre-Decree 28/165 implementation), there is substantial uncertainty in the sector regarding the legality of MFOs borrowing from abroad. Currently two MFI's (TYM and Binh Minh/SEDA) borrow from KIVA in USD with interim verbal approval from the State Bank, but this may be related to the fact that KIVA loans are interest-free.

4. Microfinance Sector Development

4.1 History

Microfinance in Viet Nam has its roots in government social protection measures for the poor. Because the vast majority of the poor population lives in rural areas, microfinance has traditionally been interpreted as the market for financial services for rural households. Micro-credit in particular has been interpreted as the provision of subsidized credit facilities for the poor, and quantitative 'coverage targets' have been promoted in response to a perceived unmet demand for credit among the rural poor. This has resulted in supply-driven efforts, led by the government 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 has been paid to the quality of the debt finance provided, the sustainability of the institutions providing the service, and the repayment capacity of borrowers. Increasingly, however, more market-led arrangements are developing.

The People's Credit Funds were established in 1993 to address the huge demand for productive credit in rural areas created by the agricultural reforms in the early 1990s after the communist credit cooperatives failed in the late 1980s.

The Hunger Eradication and Poverty Reduction Plan (HEPR) launched by the Vietnamese Government in 1997 focused on improving poor people's access to financial services, especially in rural regions. HEPR was formally established in 1998 as a nationwide framework for integrating poverty reduction efforts targeted at poor households and poor communes. Government-owned banks (Viet Nam Bank for Agriculture and Rural Development (VBARD) and Viet Nam Bank for Social Policies, VBSP) became the dominant providers of financial services to the low-income population, and used the extensive network of the political mass organizations to mobilize, appraise, and monitor clients.

Viet Nam's Party-led government has enabled the mass organizations to be important stakeholders

in the microfinance sector both at the policy and the operational level. These MOs, and the Viet Nam Women's Union in particular, have been successful in attracting project funding for microfinance, as it has been one of the only legal partners for international non-governmental organizations and programs wishing to provide microfinance in the country. Most of the *semi-formal microfinance programs* established since the 1990s are thus legally authorized, owned, or implemented by the VWU at central or local levels. Some social funds operated by mass organizations have specialized in microfinance, including the Tau Yeu May Fund (TYM) established by the VWU in 1992 and the Capital Aid Fund for Employment of the Poor (CEP), established by the Labor Confederation in Ho Chi Minh City in the same year. Today, some 28 organizations offer microfinance services in 36 provinces (57% of total provinces) but they have, with a very few exceptions, been unable to attain significant scale and sustainability.

4.2. The Retail Sector: Financial Service Providers

The Vietnamese microfinance market is characterized by the dominance in scale and depth by three formal providers, the state-owned VBARD, the policy lender VBSP and the 984 People's Credit Funds. These main providers all pursue the market for small, particularly rural loans and savings accounts, but with very different approaches. The Viet Nam Postal Savings Company, established in 1999 has the potential to become an important deposit mobilizer in Viet Nam with convenient outreach and competitive interest rates.

› **Viet Nam Bank for Agriculture and Rural Development**, VBARD or AgriBank, is the largest bank in the country and by far the largest provider of the full range of financial services in rural Viet Nam. The darling of the donor community, VBARD has implemented 111 projects at a value of \$4 billion, as at end 2007, with large and subsidized credit lines received from ADB, the World Bank, and Agence Française de Développement in particular.

VBARD specializes in lending to rural households and SMEs involved in agriculture or off-farm enterprises, but the bank has recently expanded its urban branch network to capture the market of urban SMEs. Forty-five percent of total deposits are mobilized in urban areas while 55% are lent out rurally. Through donor-funded programs and targeted credit lines, as well as the framework agreements with the mass organizations (in particular the Women's Union and Farmer's Union), the bank purports to reach some 4.7 million poor rural households⁴⁹.

- › The network of **People's Credit Funds (PCFs)** has expanded rapidly all over the country in the past 15 years. PCFs are computerized and are currently introducing an electronic payment and fund transfer product, as well as remittances, for its members, supported by the Bill and Melinda Gates Foundation⁵⁰. The PCF network has long-standing donor support from the Canadian and German cooperative movements through DID and the German development agency, Gesellschaft für Technische Zusammenarbeit (GtZ), and since 2006 has received concessional capital for on-lending also from AECI⁵¹.

15 founding members are required to set up a PCF. Being generally better off, the founding members need to provide an initial capital base of at least VND 50 million (\$3,000) by buying shares amounting to at least VND 3.3 million (\$220) each. Once registered, the PCF recruits more shareholding members at a price of VND 50,000 (\$4) per share, who are then eligible to save and take loans. About 84% of PCFs' assets are funded internally (by savings and capital).

- › The **Viet Nam Bank for Social Policy** was reconstituted in 2002 from the Viet Nam Bank for the Poor, and has a nationwide network, partly subsidized by local People's Committees. As the key government vehicle to channel

49 VBARD reports a customer base of 10 million farmers of whom 47% are considered poor.

50 Développement International Desjardins: The Bill and Melinda Gates Foundation and DID enter into agreement to develop financial cooperative interconnectivity in West Africa, Haiti and Viet Nam, January 2008.

51 AECI Viet Nam: Specific Agreement between Spanish International Cooperation Agency (AECI) and CCF, July 2005.

subsidized credit for policy purposes, VBSP is fully guaranteed by the government and exempt from taxes, state budget remittances, and the deposit insurance scheme. VBSP mobilizes an increasing amount of capital for lending, including deposits from the public, donor funds (IFAD, OPEC) and a mandatory contribution of 2% of the deposits of the SOCBs. VBSP lends primarily to small businesses in remote areas, and to households identified as poor by the LPCs, but has recently also been lending to SMEs for job creation.

Since 2006, services extended to ethnic minorities especially in the Central Highlands increased in line with the policy agenda, but loans to ethnic minorities still represented only 2% of loans outstanding in June 2006⁵². VBSP outsources client mobilization and monitoring to the mass organizations, and hence has a remarkable microfinance market penetration of 23.5% (assuming a poor and low-income market of 24 million), earning it the second-from-the-top spot in the MIX Asia 100 ranking in 2006.

The Viet Nam Postal Savings Company (VPSC) was established in 1999 as a unit of the Viet Nam Posts and Telecommunications (VNPT) to mobilize idle money from the public through the national post office network. It is not allowed to provide credit or open business accounts, but offers transfers and term, current, and 'collection' savings accounts. The mobilized deposits are transferred to the government for project investments, primarily via the Viet Nam Development Bank, which dampens the incentive for the VPSC to increase savings mobilization. When VNPT restructured into an economic group, the VPSC became a subsidiary. It started its equitization process in 2007 and plans to get licensed as a commercial retail bank for the VNPT group.

- › **Semi-formal Microfinance Organizations** are intrinsically linked to mass organizations in Viet Nam that legally govern, sponsor, or work in cooperation with *International Non-Governmental Organizations (INGOs)* to implement microfinance programs.

52 VBSP: Operation of Viet Nam bank for social policies in contribution to poverty alleviation, November 2006.

The Women's Union (VWU), Farmers' Union and the Youth Union, with a combined membership of about 20 million, are all managing group loan and savings schemes, implementing INGO-supported microfinance projects, and linking clients to VBARD and VBSP through framework agreements⁵³. Mass organizations are involved in providing loan guarantees, group formation and monitoring, checking clients' credit history, and delinquency management. The VWU has no specialized microfinance units, but has integrated the savings and credit operations with other (primarily social) activities, employing its existing staff and organizational structure. With Decree 165 coming into effect, VWU has contracted technical assistance to determine the future of

⁵³ Both VBARD and VBSP have signed Framework Agreements with MOs in many areas that 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 against a small commission.

their ACCESS Program and the broader future role of VWU in microfinance⁵⁴. As of June 2008, there were 25 semi-formal microfinance organizations reporting their outreach and financial data to the Viet Nam Microfinance Working Group (MFWG). In total, these 25 MFOs reach 183,586 clients as of December 31, 2007 with a loan portfolio of \$16,657,888. The average loan size is \$80-90. The largest programs are: the Capital Fund for Employment of the Poor (CEP), the ACCESS Program (WU), Tao Yeu May Fund (TYM), the Capital Fund for Employment of the Poor in Ba Ria Vung Tau, WU - Ha Tinh, and the seven microfinance programs that form part of the 'M7 network'. Currently, four MFOs report to the global microfinance database, the MIX Market, as does VBSP.

⁵⁴ VWU and BTC: Procurement of Feasibility Study for ACCESS revolving Fund and Microfinance activities within the Viet Nam Women's Union, Terms of Reference, May, 2008.

Table 15. Description of main MFOs

CEP (Capital Fund for Employment of the Poor)	CEP is the oldest and largest of the semi-formal MFOs in Viet Nam, established in 1991 by the Labor Confederation to create employment and job opportunities for the urban poor in all 24 districts of Ho Chi Minh City. It is currently expanding into peri-urban areas. CEP is recognized by the government, but remains an NGO. CEP has accessed debt to finance growth and has a debt/equity ratio of 93% (2007), of which 60% is compulsory savings. Most of CEP's debt is unsecured, interest free or concessionary, and each loan is earmarked to a specific project. As of December 2007, CEP had a loan portfolio of \$12,995,813 reaching 74,360 clients. The average loan size is \$ 175.
Tao Yeu May (TYM) Fund	TYM is a Grameen replicator founded in 1992 by the VWU with 26 branches in nine provinces in northern Viet Nam serving women exclusively. The program has received significant technical and capital grant assistance from a number of donors, including CARD, Grameen Trust, CORDAID and the German Savings Banks Foundation, and has also accessed quasi-commercial debt finance (debt/equity ratio 118% as of December 2007). As a first step towards transformation into a licensed microfinance provider, TYM was instituted as a separate legal entity (non-bank financial institution) with a management board in January 2006, and has been recognized by the Government. As of June 2008, TYM had a loan portfolio of \$6,299,308 reaching 30,869 borrowers. The average loan size is \$204.
M7 Network	M7 is a network of seven microfinance programs started by Action Aid. They include M7 Mai Son, M7 Uong Bi, M7 Dien Bien Phu town, M7 Dien Bien Phu Province, M7 Dong Trieu, M7 Ninh Phuoc, and M7 Can Loc. The network covers 52 communes in seven districts. Of the 31,492 active members, about 7,289 come from ethnic minority groups. Currently, four M7 members are registered as social funds are regulated by Decree 177 and one is registered as an NGO. As of December 2007, the seven M7 MFOs have a consolidated loan portfolio of \$2,865,862 reaching 31,492 members. Average loan size is \$113.

› Several **informal savings and credit groups** complete the crowded but fragmented market for microfinance in Viet Nam. These local, semi-structured and truly 'private' informal finance entities exist in almost every hamlet of Viet Nam as a well-integrated part of the communal safety net. They include *Rotating Savings and Credit Associations (ROSCAs)*, referred to as Ho in the North and Hui in the South. In the ROSCAs, periodic savings contributions from members are pooled and disbursed to one member at a time on a rotating basis. Interest rates, membership

and loan amounts are decided on either jointly, by a bidding process, or by the organizer. Similar savings and credit groups are also operated among many mass organization members at the local level. As in most other developing countries, traders, shopkeepers and *money lenders* have been an important source of informal credit in Viet Nam. 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.

Table 16. Nine Fast Facts about Microfinance in Viet Nam

Vietnamese MFOs vs. their Global Peers – Nine Fast Facts

The "typical" microfinance organization (MFO) in Viet Nam differs in many ways from those elsewhere in Asia or the world, as benchmarked by the Microfinance Bulletin. Below are nine of the most salient points that make Vietnamese MFOs unique:

1. They are **not privately owned**. Due to the absence of a legal framework for MFIs and the 'Viet Nam-specific' role that mass organizations have, all MFOs in Viet Nam are owned by public or semi-public entities, even if independent management boards may be in place. Licensing under Decrees 28/165 will legalize private ownership structures, which commercial investors in general prefer.
2. They are **small**. They have fewer clients and smaller loan portfolios than their international peer MFIs. Their average number of clients is half the global average of MFIs and one-third of the average for Asian MFIs, even at similar age. Their average loan portfolio is one tenth of the international average for MFIs.
3. They have **lower (recorded) expenses**, both in terms of operational and financing costs, than their international peers. This may be because Vietnamese MFOs receive a number of implicit subsidies from the Women's Union ranging from free rent to heavily-subsidized credit officers' salaries.
4. Because the costs are lower, Vietnamese MFOs are **better able to cover their (reported) expenses** than international MFIs (as measured by OSS).
5. They are **more poverty-focused** by having a smaller loan sizes than their international peers (relative to the per capita income of the country).
6. They lend almost entirely to **women** – unlike many MFIs outside Asia.
7. They generally **do not borrow**, like their foreign counterparts. They are funded almost entirely by donations, equity, and savings. This reflects the absence of microfinance regulations that permit borrowing and may change with Decree 28/165 – although many Vietnamese MFOs may be too small to attract lenders.
8. **They charge lower interest rates**, as measured by their portfolio yield (nominal). As a result, they only have around half to one-third of the revenue/assets of their international peers. This may be because of the competition from the subsidized lender VBSP, or because lower (reported) expenses allow MFPs to charge lower interest rates while still covering costs.
9. Credit officers are **more productive**, with a higher caseload for credit officers. This relates primarily to the prevalence of group lending products among Vietnamese MFOs, but may also be partly explained by the relatively high population density in Viet Nam (particularly in some rural areas) and by the fact that client monitoring activities are often done by Women's Union staff on behalf of or as seconded staff to the MFO.

The MFWG's June 2008 Bulletin will provide a benchmarking analysis comparing MFIs in Vietnam to peer group MFIs in Asia and worldwide. This table is based on an upcoming article by Steven Penning, Save the Children/US

4.2.1 Products and Services

The market for microfinance services in Viet Nam 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. There is budding interest among some JSCBs, such as TechCombank - with support from the International Finance Corporation (IFC) - to down-scale to the urban micro-market, which is primarily served by PCFs, the VBSP, and some microfinance organizations (MFOs). In the rural areas, VBARD, VBSP, some PCFs, and the MFOs constitute the main providers of micro-credit and savings.

Credit Products⁵⁵

With a specialized agricultural bank, agricultural loan products are more easily available in Viet Nam than in many other countries. 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%), handicrafts and trade (10%), and rural infrastructure. Due to both risk adversity and to the restrictions imposed on donor credit lines, VBARD does not in general offer emergency loans or consumption loans to poor households.

⁵⁵ The sections on product range are updated from DFC/World Bank: Viet Nam: A Comprehensive Strategy to Expand the Access [for the poor] to Microfinance Services, Vol. I: The Microfinance Landscape in Viet Nam, February 2007.

Table 17. Key characteristics of the microfinance providers

	VBARD	VBSP	VPSC	PCFs	CEP	TYM	MFWG other [^]	Total
Outreach								
# of branches	2,096	8,749	8,000	986	24	26	108	19,989
# of borrowers	4,900,000	5,648,140	none	1,209,042	68,490	30,869	183,586	16,540,124
% women	..	61	..	38	75	100	95	
Gross portfolio \$	..	2,166,443,066	None	732,000,000	12,995,813	6,299,308	16,567,888	10,156,486,822
Avg. loan balance \$	850	383	..	610	175	204	80	
# of savers	5,400,000	Est. 170,000	..	1,000,000	21,157	29,326	170,000	6,617,924
Savings volume \$	8,460,418,864 (55% of tot)	51,008,303	2,680,000,000	583,000,000	588,284	3,490	30,000	
Avg. savings balance	1,567	Est. 300	112-557	583	28	5	6.35	
Loans per credit officer	..	2,833	..	..	651	306	173	
PaR(30)	..	3.2%	..	..	1.19%	0.07%	0.06%	
RoA	1.61	-2.66	..	..	8.16	5.4	4%	
RoE	69.3	-9.39	..	..	15.75	11.75	5%	
OSS	..	72.65	..	..	156%	160%	157%	

Sources: The MIX Market microfinance database (Dec 2007), VBARD Annual Report 2007; Basic Data on MFOs in Viet Nam (Jun 2007); World Bank (2006) The Microfinance Landscape in Vietnam Volume 1 ^Data as of the 31/12/2007, Source: VMFWG, data are sums or medians, risk and financial performance data may be unreliable because self report.

Table 18. 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 p.a.	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	-	-
Interest rate p.a.	8.5–12.9%	11.4-15.6%	9.6-16.2%		
% collateral	70-100%	70-167%			
Investment/working cap. (MSMEs) including agriculture (VBARD)	Max. 85%	11-158bn (max 85%)	1mn-180mn	5m-500mn	Max 20 mn
Interest rate p.a.	8.5-12.9%	10-15.6%	9.6-17.4%	10.8%	12-24%
% collateral	70-100%	70-167%			50%
Poor households	-	1mn-50mn	500,000-9mn	-	-
Interest rate p.a.		11.4-15.6%	8.4-16.2%		
% collateral		70-100%	70-100%		
Group loans	-	-	-	-	0.47-20mn
Interest rate p.a.					10.32-12%
% collateral					50%
Uncollateralized loans:					
SOCBs					
JSCBs					
PCFs					
VBSP					
MFWG					
Consumption loan range (VND)	-	-	0.10–130mn	Max. 10 mn	0.10-20mn
Interest rate			9.6-17.4%	7.8%	9.6-12.2%
Mortgage/housing	-	-	1mn-300 mn	Max. 200 mn	Max. 15 mn
			9.6-16.2%	7.8%	6-36 months
					7.8-14.4%
Investment/working cap. (MSMEs)	Max. 10 mn	-	1mn-180mn	Max. 10 mn	0.28-20mn
	9.6-12.9%		9.6-17.4%	9.6%	9.6-24%
Poor households	-	-	500,000-9mn	Max 30 mn	0.28-20mn
			8.4-16.2%	7.8%	11.3-24%

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 (\$625) to poor farmers and rural households, which are formally collateral-free, but in practice borrowers must often leave their land use certificate with the bank until

the loan is repaid, or be sponsored (guaranteed) by a mass organization. Such small loans are short-term, typically six to 12 months, and interest rates have ranged from 9.6 to 12% p.a. per month until the recent interest hike in May 2008. 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. Debt rescheduling is not uncommon and frozen accounts are not included in arrears reported⁵⁶.

VBSP lends to households identified as poor by the LPC certificate and to small and medium-sized businesses in remote areas (for employment creation under the government's "Program 120"). For poor households, the maximum loan amount without collateral is VND 10 million (\$625), while collateralized investment loans of up to VND 500 million (\$31,215) are also provided. The loan terms do not normally exceed three years and repayments of principal are quarterly (for small loans) or at the end of the term, while interest repayments are monthly. VBSP also provides credit to poor students, poor workers seeking employment or returning from overseas, and for specific purposes, including water and sanitation, non-timber forest product development, and construction of housing (either to buy/build a house with installment repayment or to companies to build housing). In all products, ethnic minorities are given priority. Loans are generally without physical collateral but VBSP enters into framework agreements with mass organizations and pays a very small, performance-based remuneration to the MOs (0.06% per month 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 from 13.2 to 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 moneylenders⁵⁷.

56 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.

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

Most INGO-supported programs use a solidarity-group methodology, either of the village bank or Grameen type, while a few also provide individual loans and housing loans. Interest rates range between 0.8 and 2% per month, calculated on a flat or declining balance. Many of the schemes offer financial services as part of an integrated package of other activities⁵⁸. CEP in Ho Chi Minh City provides individual loans with a flexible daily, weekly, and monthly repayment schedule catering to the urban traders in its portfolio. In collaboration with Habitat for Humanity, a housing improvement loan product was recently introduced by the Women's Union of Kien Giang Province (WUKG) which also participates in ACCESS, TYM, and CEP⁵⁹. CEP also offers loans for sanitation. In addition to the standard Grameen-type group guaranteed loan, TYM offers a multi-purpose (emergency/consumption) loan with lower amounts and short tenor.

Some agricultural production cooperatives have started savings and credit operations for their members in recent years, and are reported to have around 15,000 members. The cooperatives provide individual loans to members as well as loans in-kind (rice).

Savings Products

The supply of savings products in Viet Nam is equally standardized but relatively widely available. 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, such as at VBARD. Campaigns and drives to open savings accounts for children have been quite successful but the big market players have yet to offer the very short-term (liquid) and low-threshold savings accounts popular globally among poor households.

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

59 For lessons learned from this pilot project, see MicroNote 35: Habitat for Humanity Viet Nam Partnering with MFIs to improve housing for the Poor. <http://www.microlinks.org>

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. The VPSC has recently (June 2008) raised its interest on term deposits to 16.2% p.a. to attract deposits in preparation for privatization.

About a third of the INGO-programs offer savings services at interests ranging from 2.4 to 6% p.a. Most MFOs 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 MFOs 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 programs implemented with the VWU require borrowers to deposit into a compulsory 'mutual assistance fund' from which funds can be accessed as emergency loans in case of illness or cover for write-off in case of death as a precursor for credit-life insurance. In addition, TYM requires a weekly compulsory deposit of VND 3,000 (\$0.60) earning an interest of 3.6% p.a. and offers the lowest minimum balance on voluntary savings along with a new 'family savings' term deposit product.

Other financial products and 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. In addition to its 2,096 branches and mobile units, VBARD has 802 ATMs and offers debit and credit cards along with telephone and internet banking, and is linked to 931 corresponding banks internationally.

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 some PCFs, and access is thus relatively easy. VBARD is linked to Western Union, transacting \$340 million in remittances in 2007, up 71% from 2006. The cost of cash transfers

in the market does 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, however most of the formal financial institutions charge a percentage of the transfer value as transaction fee. Surprisingly, one of the nine leasing companies and VBSP also report that they are offering money transfer services for customers – the leasing company doing so competitively at 0.02%. In September 2007, Citibank and VPSC entered into a partnership to enable customers to make electronic payments of bills and transfers from their personal accounts at the post office to firms banking with Citibank.

The 12 leasing companies in Viet Nam do not at present cater to the low-end of the market (the average value per lease is over \$90,000), but offer leasing finance for urban-based SMEs, primarily within transport and services. Under a pilot project supported by IFC-MPDF, the Viet Nam International Leasing Company was provided a credit line from Dutch FMO to provide individual leases under \$10,000 for equipment and vehicles for (M)SMEs⁶⁰.

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 formal life insurers, to down-scale.

Microfinance programs with the mass organizations have developed informal insurance products such as mutual assistance and aid funds, as well as hunger and calamity reserves, and a few MFOs have developed an informal credit-life product, where in some cases, the household of the insured person also receives a funeral grant. When Decree 28/165 enters into force, however, licensed MFIs can no longer provide microinsurance services on their own, but they may become agents of regulated insurance companies. Linking existing services to regulated insurance providers has therefore been a priority in recent years, an effort spearheaded

⁶⁰ World Bank: SME Facts Vol 2, 1/2001.

Table 19. Overview of savings services in Viet Nam

	SOCBs	JSCBs	VPSC	PCFs	VBSP	MFWG
Current/checking accounts Min. balance Interest rate p.a.	100,000 2.4%	100,000 3-3.6%	..	3.6%	2.4%	..
Savings accounts (some with check or savings book) Min. balance Interest rate p.a.	100,000 2.4%	100,000 3-3.6%	2.4-8.2%	3.6%	6-7.2%	TYM 1,000 2.4-6%
Term (time/fixed) deposits Min. balance Interest rates p.a.	100,000 2.4-9.36%	100,000 7-9.24%	16.2% (06/08)	3.6-11.2%	7.56-8.16%	..
Compulsory savings (loan guarantee) Min. deposit/month (VND) Interest rates p.a.	..	..	..	9.72%	10,000 2.4%	12,000 2.4-6%

by the International Labor Organization (ILO) through its project, "Extension of Microfinance and Microinsurance to Informal Women Workers". This project has been in implementation since 2003 in collaboration with MOLISA and has been supporting the microfinance industry through product development, capacity building, and policy advice/networking. A new IFAD-funded global project is supporting the Micro-Insurance Centre and Microfinance Opportunities to develop new products and delivery channels, and to introduce financial education in Viet Nam on micro-insurance.

In addition, Bao Viet has launched a voluntary pension insurance scheme. Prudential offers an insurance product for women and children, and AIA (US) and the JSCB Southern Bank signed an agency agreement in 2006 making a credit life insurance product to the borrowers of the bank.

In order to maintain and develop their mutual assistance funds after registration under Decree 28/165, several MFOs are currently exploring ways to establish independent microinsurance subsidiaries. The TYM fund has advanced the furthest in this regard. The VWU has approved

a pilot project which eventually could lead to the creation of a Mutual Assistance Insurance (MAI) Fund under Decree 18. Based on a client needs assessment and an actuarial analysis, TYM contracted external technical assistance to develop a comprehensive life, hospitalization and credit life insurance package. A separate full-time insurance management team with separate accounts has been set up.

Donors are currently assessing the feasibility of a Microinsurance Protection Fund, which would cover extreme shocks such as natural disasters or sudden financial crisis. Such a fund could eliminate the need to arrange for expensive commercial re-insurance and may allow a MAI to register with lower minimum capital than the current requirement of VND 10 billion (or US\$ 600,000).

The rapidly developing non-life insurance market in Viet Nam has also 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

poorer households and farmers. These include livestock insurance schemes⁶¹, industrial crop insurance (for cashew nuts and coffee), and personal accident and health insurance. In light of Viet Nam's past experience with agricultural insurance, and based on a recent study of Dong Thap Province, a new flood index insurance offered over the short term (June 20 to July 10), when early flooding interferes with the rice harvest in the region, is being piloted⁶².

4.2.2 Market Gaps

Despite the financial deepening and recent developments, there are both quantitative and qualitative gaps in the Vietnamese financial market:

1. The largest quantitative gap relates to the 'missing middle' of small businesses and non-poor households, rather than to the poor. The gap reflects an increasing segmentation and sophistication in the demand for financial services (see Figure 10), which the financial services providers are not meeting. In addition to more flexible credit services (such as higher loan

sizes, longer loan terms, and varied repayment options), the market is also looking for a greater diversity of financial services, including leasing, remittances, small-balance savings and insurance products.

2. The largest qualitative gap relates to the financial services available to BOP. While credit is available to the majority of BOP, the quality of these services, and the range of products provided, is not meeting the demand for well-designed, affordable and customer-responsive financial products delivered flexibly and conveniently. To respond to these market demands and at the same time increase sustainability, however, will require providers to embrace a higher level of innovation, efficiency, and market adaptation than exists today, and may also require higher interest rates. The larger, more established, and better capitalized main players (VBARD, the PCFs, some urban JSCBs, and VBSP) require better market information, political permission, appraisal tools and systems to meet the growing and diversifying demand more responsively. Targeted donor credit made available for intermediation will not necessarily support the internal development process of understanding how the BOP market segment can become profitable. There is room for some MFIs, once

61 Thomas Dufhues, Ute Lemke and Isabel Fisher: New ways for rural finance? Livestock insurance schemes in Viet Nam, Berlin Conference, October 5-7, 2004.

62 See also: J. Skees: Challenges for Use of Weather-based Index Insurance in Lower Income Countries, July 2007.

Table 20. Innovations in Microinsurance

Using the Partner-agent Model to Provide Microinsurance to Low Income Market:

The experience of M7 Ninh Phuoc DWAF (Ninh Thuan province), Viet Nam

Under the "partner-agent model" of microinsurance, a commercial insurance company (such as Bao Viet or AIG) partners with a local "delivery channel", such as a microfinance program, the Women's Union, the Labor Union or PetroVietnam, to distribute microinsurance products. Typically the insurance company manages the premiums and funds the payout of claims, with the distribution network receiving a commission for premium collecting and product servicing.

In January 2005, the M7 Ninh Phuoc Development Assistance Women's Fund (DWAF) launched a pilot credit life microinsurance product in partnership with Bao Viet. The annual premium is 0.9% of the loan with payouts equal to 100% or 50% of initial loan size with the death or permanent disability of the woman borrower or her husband, respectively (in the most recent policy).

For more information, refer to upcoming article, "Using the Partner-agent Model to Provide Microinsurance to Low Income Market: The experience of M7 Ninh Phuoc DWAF (Ninh Thuan Province), Viet Nam. The article will be published in MFWG Bulletin June 2008.

licensed, to serve this higher-end market, but this will require a shift in vision from poverty alleviation to inclusive economic development, which not all MFIs would be willing to entertain. In addition, the distortionary effects of the subsidized VBSP in the market means that competition cannot be on price – it has to be on quality.

3. Finally, customers in rural areas of Viet Nam who 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 for high-quality BDS that is not currently being met.

4.2.3 Trends and Innovations

Competition in the formal sector has increased dramatically with the frenzied credit growth over the past year and the pace of growth itself merits concern about credit quality. While VBARD has increased provisioning, it is not clear that all JSCBs have the equity base, provisioning and risk management systems in place to manage the dramatic portfolio increase. Due to demand expansions in the middle income segment of the population, the competition has not (yet) led to major down-scaling by commercial players, which may also be hampered by the continued presence of the policy lending vehicle VBSP. Monetary and fiscal policies being implemented by the SBV to curb inflation are affecting the financial sector; liquidity is decreasing and credit growth is expected to slow over the coming year. The flip-side of the liquidity crunch is significant increases in the deposit rates offered by formal financial institutions, and it must be expected that voluntary savers may move from semi-formal programs to formal providers due to the higher interest rates to be gained.

The largest provider, VBARD, while beginning to diversify, has as its main objective to serve the rural market. However, it reaches the poorer segment only through subsidized credit lines from donors or with guarantees from the mass organizations, and appears as yet unconvinced of the profitability of serving BOP, perhaps because it cannot compete head-on with the subsidized VBSP. For VBARD to increase down-scaling more sustainably, the competitive playing field with VBSP needs to become more level.

The PCFs are possibly the most demand-oriented of the financial service providers in Viet Nam. However, even those that are operating profitably are not allowed to expand beyond the commune where they have registered, which hampers their growth. 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 them to grow their portfolio, hence serving more people – also among the BOP.

Telecommunications have developed very rapidly in Viet Nam, and ownership of mobile telephones has exploded, from 4.8 million in 2004 to 35.2 million in 2007. Assuming one handset per person, coverage has reached over 40% of the population⁶³. With the mobile phones, mobile marketing was first introduced by Viet Nam Post and Telecommunications Group (an economic group) in 2006, but has now expanded especially to the financial, insurance and securities companies, with ACB, Techcombank and Vietcombank leading this innovative market niche. These banks, and a few others, offer not only 'tele-marketing' (information on interest rates, new services) but also mobile banking services (monitoring of accounts, payment of bills, and transfers)⁶⁴.

63 GSO: Statistical Year Book of Viet Nam, 2007.

64 Mobilemarketing: "Good Morning Viet Nam! Mobile Marketing has arrived", Mar 24, 2008.

VBSP operates 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, for example to charge cost-covering interest rates so that it can increase capital mobilization, and much earlier than 2020 as their plans call for. This would benefit not only VBSP and its clients, but the entire microfinance industry.

Similarly, another important aspect of successful industry development in Viet Nam will be the future role for mass organizations, and in particular for VWU in the new regulatory environment. The results of the ongoing feasibility study to determine the role of VWU and the future of the largest VWU project ACCESS will be of great importance in this process.

Growth in the semi-formal microfinance industry has stagnated over the past two to three years due to the ambiguity about the legislative and regulatory framework for its development, but the main trend has been the preparation for licensing and transformation. With the revised decree, the microfinance providers hope that SBV and Ministry of Finance will soon publish the remaining Circulars and guidelines, as the due date for application for an MFI license is fast approaching. MFOs have been testing innovative business models and partnerships, piloting new products (especially for consumption loans, housing finance and micro insurance), improving their transparency, and exploring ways to attract foreign capital. Some innovations are summarized below:

Business Models and Partnerships

- › In 2004, the Binh Minh (Sunrise) Community Development Consulting Company Limited (BM CDC) was established as a limited liability company to manage the services of an urban microfinance program supported by SCF-US under a legal framework agreement with VWU.
- › In January 2006, the microfinance program TYM, owned by the VWU, was transformed into a separate legal entity (subsidiary) with its own management board.

- › As of June 2008, four M7 network members were registered as social funds and one was registered as an NGO. They are studying the feasibility of jointly transforming into a licensed MFI under Decree 28/165.
- › The VWU-managed ACCESS program is conducting a feasibility study to determine a future for its large revolving credit fund and the broader role of VWU in the changing microfinance market.

Product Development

- › Two MFOs are currently testing individual lending methods instead of the group guaranteed model prevalent in Viet Nam.
- › Several MFOs have signed agent agreements with Bao Viet to offer micro-insurance (credit life) products to customers. CEP also offers a health insurance product for customers who cannot access public health care.
- › Habitat for Humanity piloted a housing improvement loan with CEP and the Women's Union of Kien Giang Province. Results were mixed and demonstrated the need for clear delineation of responsibilities and roles in partnerships between NGOs and MFOs. Drawing on these lessons, TYM and Habitat recently signed a loan and technical assistance agreement to provide housing improvements for TYM's clients.
- › Several MFOs, including ACCESS, TYM, and CEP offer non-financial services to customers, such as educational materials, financial education, and business development services training for clients. CEP and VBSP are formal partners of the Citi Foundation-founded Global Financial Education Program.

Transparency

- › CEP has been, and TYM will soon be, rated by the French rating company PlanetRating.
- › Four MFOs (CEP, TYM, Binh Minh and TCVM Thanh Hoa), and VBSP, are now reporting to the MIX global microfinance database.

- › The MFWG and the Mix Market are finalizing an agreement that could see the development of a MIX Market benchmarking report for Viet Nam.
- › The Citi Foundation's Micro-entrepreneurship Awards Program was introduced to Viet Nam in 2007 in collaboration with the MFWG and the Microfinance and Development Center. The first Awards Ceremony took place in December 2007, where 60 micro-entrepreneurs and 30 loan officers received prizes, enhancing the visibility of microfinance in the country.

Access to Capital

- › Three MFOs (TYM, SEDA/Binh Minh and Mekong Plus) joined the KIVA network in 2007 to mobilize (interest-free) capital for microloans by individuals via the Internet. The SCF-US funded Thanh Hoa program has also applied.
- › GRET is implementing the PlanetFinance project "Increasing Business Opportunities between European Social Investment Funds and MFIs in Asia" in Viet Nam, aiming to increase information flow to potential investors about MFOs in the country; train MFOs to fulfill the requirements of an investor's due diligence; and arrange a marketing conference.

Portfolio quality has been consistently excellent for the vast majority of the major semi-formal MFOs, and both efficiency levels and financial performance has improved over the past five years, as documented by the four semi-formal MFOs that are reporting to the MIX database together with VBSP (three MFOs were operationally sustainable in 2007). Due in part to the delay in the provision of a legal framework for transformation, no MFO has accessed commercial credit yet, but CEP is now borrowing on concessional terms. Access to capital is clearly a constraint for MFOs and it is encouraging that several quasi-commercial funders have scoped the market in Viet Nam. Institutions like Triple Jump, Unitus, and Grameen Foundation-USA have visited. One investor is currently completing its due diligence of an MFO in Hanoi. It will be important in the coming years to ensure that resident donors come on board with 'Good Practice-based' funding

after many years of using the SOCBs, VBSP and some MFOs as vehicles for channeling concessional funds to meet social targets.

4.3 Microfinance – 'Meso-Level' Organizations

4.3.1 National Associations and Networks

Viet Nam has a number of national associations and networks supporting the formal financial sector and the emerging microfinance sector. In addition to the Viet Nam Banks Association (VNBA), the Viet Nam Association of People's Credit Funds (VAPCF), the Viet Nam Microfinance Working Group (MFWG), and the M7 Network support the microfinance sector.

The VAPCF was established in June 2005 and they currently have a main office in Hanoi and two representative offices. The main services they provide to PCFs are dissemination of key legal information on new government decisions, facilitating training and consulting, maintaining website and other information-sharing activities, fostering dialogue with state agencies, and international relations. VAPCF is supported by Desjardins, First Initiative, GtZ, Ford Foundation, World Bank, and the Asian Development Bank.

The Microfinance Working Group (MFWG) was revived in 2003 to create a focal point for lobbying and advocacy efforts. The MFWG now provides services including facilitating the dialogue with SBV and other government authorities, regular meetings to share lessons learned, maintaining a database of microfinance programs in Viet Nam, and raising awareness of microfinance. MFWG also links practitioners to microfinance training events. A key achievement of the MFWG is the publication of the Viet Nam Microfinance Bulletin which provides outreach and financial data of 25 MFOs and VBSP on a semi-annual basis. In a sector with little transparency, this is an important step forward. As of June 2008, the membership remains open, and there are more than 50 participants. With support from ADA and Ford Foundation, and following a network capacity assessment (NCAT) conducted by SEEP in 2006, the formalization

process is now moving forward and as of June 2008, the MFWG is engaged in a strategic and business planning process to create a formal association with support from SEEP.

The M7 network was formed in July 2006 (with support from the McKnight Foundation) and represents seven MFOs initiated by ActionAid from 1993 to 2003. M7's main activities include conducting training courses, providing technical assistance including the development of an electronic information system, and publishing leaflets. M7's most significant achievement in 2007 was the establishment of a supporting organization called the Community Finance Resource Center (CFRC).

Despite the number of meso-level associations and networks, there is little direct contact and coordination between the semi-formal and the regulated MFOs 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.

4.3.2 Training and Consultancy

Many banks run their own in-house training programs for staff. The main external training provider for the *formal financial institutions* is the private Banking Training and Consultancy (BTC) established in 2001 with support from the IFC-funded Mekong Private Sector Development Facility (MPDF). The PCFs are primarily accessing training and technical assistance (TA) through DID and GtZ and some courses tailored for PCFs are directly provided by the National Economics University in Ha Noi and Ho Chi Minh City.

In the *microfinance industry*, training and TA is very limited. For the most part, training and TA have been provided by the ILO and International NGOs that support microfinance. The ILO has also supported Training of Trainers (TOT) courses and has translated and adapted different curricula to the local context including some CGAP courses. In addition, some multilateral and bilateral projects also include capacity building for local counterparts (usually MOs) in their projects.

As of October 2007, the main training providers in Viet Nam are the Viet Nam Development Information Center (VDIC), ILO, and CFRC (see Table 21). There are few local consulting firms or technical assistance providers that have specialized in microfinance, with the possible exception of Mekong Economics. Training and TA is also provided by foreign organizations, including CARD (Philippines), Grameen Foundation (USA), MicroSave (Kenya) and CGAP (USA).

There are many plans to establish microfinance training centers in Viet Nam given the large demand for responsive and competent microfinance capacity building. The PCFs, MFWG, CEP, and TYM have all explored plans to develop a training center. Although a training center could address a gap in the market there is also a gap in other support services, such as TA, MIS/IT support, and specialized audit tailored for microfinance. Rather than focus on creating an NGO training center, it may be more feasible to establish a commercially viable service provider for the emerging microfinance industry. Such a (private sector) provider could attract and pool existing and potential resources and could be established under the Law on Enterprises.

4.3.3 Other Industry Support Services

There are no official *rating agencies* incorporated in Viet Nam but PlanetFinance (affiliated with PlanetRating) has recently entered the market. The Ministry of Finance is considering establishment of the first domestic rating agency in the country with no government stake, possibly owned jointly by local financial institutions, foreign credit rating agencies, and international organizations.⁶⁵ The largest MFO, CEP, was rated by Planet Rating in 2003 and TYM will be rated, also by Planet Rating, later this year.

There are no *credit reference services* available to MFOs at present in Viet Nam. The Credit Information Center (CIC) is a public registry under the supervision of the State Bank of Viet Nam and provides the only credit information available to participating commercial banks.

⁶⁵ IFC, Viet Nam Financial Sector Diagnostic, 2007.

Table 21. MF Training Providers in Viet Nam

Training Provider	Course	Target audience
Viet Nam Development Information Center (VDIC) Start date: 2004	<ul style="list-style-type: none"> › The United Nations Capital Development Fund’s (UNCDF) Microfinance Distance Learning Course (in partnership with Asian Development Bank Institute (ADBI), the Tokyo Development Learning Center (TDLC), the Global Development Learning Network in East Asia and the Pacific › Microfinance fundamental concepts, customers and credit methodologies › Financial management and measuring financial viability of MFIs › Gauging institutional viability. 	MF Trainers MF Practitioners
International Labor Organization (ILO) Project date: 2003-2008	<ul style="list-style-type: none"> › Making Microfinance Work: Managing for Improved Performance (ILO) › New Product Development (ILO) › Making Micorinsurance Work (ILO) › Financial Analysis (CGAP) › Communication and customer care skills › Market Research for Microfinance (MicroSave, CARD) 	MF Practitioners MFOs
Community Financial Resources Center (CFRC) Start date: April 2007	<ul style="list-style-type: none"> › Accounting for Community Finance Organizations › Financial Sustainability Planning for MFIs › Organizational Structure and Governance of MFIs › Establishing a Salary System for MFIs › Establishing and Managing a Revolving Loan Fund › Accounting and Internal Controls for MFIs. › Supervision work for MFIs › Clusters Operational Management 	M7 members Women’s Union programs

Updated from ILO Report, Moving Forward- Scaling Up Microfinance Training in Viet Nam”, October 2007.

However, it only collects information on large corporate and SOE loans from banks and is not organized, structured, or staffed with the resources needed to cover SMEs or consumer loans⁶⁶. In the current overheated market, there is an unquantified 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.

66 IFC, Viet Nam Financial Sector Diagnostic, 2007.

In addition, multiple borrowing is by-and-large un-assessed. If 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 MFOs would be the hardest hit. There are some donor and funding agencies supporting microfinance in Viet Nam, but most funding is made available to support rural credit and SME development. The key donors are Asian Development Bank, World Bank, KfW/

5. Funding Source

GtZ, AFD, AusAid, Ford Foundation, CIDA, and the Belgian Directorate-General for Development Cooperation (DGDC)⁶⁷. The lack of a conducive enabling environment has essentially discouraged large amounts of donor funding to support microfinance activities provided by semi-formal organizations.

The government has contributed capital to all of the formal financial service providers serving BOP. In addition, international donors have allocated significant amounts of credit to the banking sector for on-lending to SMEs and individuals. The SOCBs and some JSCBs have access to donor credit lines either directly, through specialized units such as the Transaction Center III (of BIDV which functions entirely as an intermediary of World Bank credit), or through donor-funded projects such as the EU-funded SMEPF. Policy lenders (VBSP and VDB) access budget funds and 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. The directed donor 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) 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 appears to apply a more demand-driven approach. 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 or the rural poor using their own resources. Moreover, there does not seem to be any clear exit strategy 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 Microfinance Loan Fund (MLF) under the 2nd Rural Finance Project of the World Bank, instituted in 2002, allocated \$28 million for lending to

Microfinance Institutions including commercial and Joint Stock banks, credit cooperatives, PCFs and credit-granting NGOs accredited by the BIDV as the implementing agency. However, by 2006, 95% of the credit funds allocated through the otherwise well-designed MLF had been channeled through VBARD, and no PCF nor any semi-formal MFO was accredited for access to loan capital or the institutional strengthening envisaged under the program. The follow-on 3rd Rural Finance Project approved in May 2008 allocates \$10 million (\$5 million from IDA) to increase rural poor access to microfinance, but the operating system is not changed, so it remains questionable whether PCFs or NGOs can access funds until they are licensed following the implementation of Decree 28/165.

In addition, the First Initiative funded the formation of a Peoples Credit Fund (PCF) association in 2005 to strengthen the cohesiveness of the PCF network and provide a more stable and effective financial system for the poor. The main purpose of this project is to support the development of the PCF Association, whose main role will be to advise and assist its member PCFs by providing a service that will enable PCFs to serve their customers. Project costs total \$360,000.⁶⁸

AusAid has provided \$6 million for the CEP Microfinance Expansion Project. Of this, \$4 million is being used for on-lending to the poor. The remainder is being used for technical assistance, building capacity, and improving management systems.⁶⁹ Ford Foundation, Citi Foundation and SEEP has supported activities with the MFWG.

And finally, the Belgian Government has been supporting the ACCESS program, implemented by VWU since 1997, through three successive phases at a total funding value of around Euro 10 million. A feasibility study is currently ongoing to determine the future of the considerable revolving loan fund built up in the project and the future of VWU in microfinance more broadly. This study is seen as part of the exit strategy for the otherwise longest standing bilateral microfinance donor in Viet Nam.

67 For an overview of existing donor funding to the financial sector, see Financial Sector Assistance Projects in Viet Nam: Financial Sector Donor Working Group: "Active Projects as of November 2007".

68 For more information, refer to <http://www.firstinitiative.org/Projects/projectdisplay.cfm?iProjectID=390>

69 For more information, refer to <http://www.usaid.gov/pressroom/pressreleases/2007/07/2007072001.htm>

6. Impact Assessment and Poverty Measurement

The largest MFOs (CEP and TYM) have conducted impact studies to assess if microfinance services reduce the poverty levels of their clients, and to evaluate whether adjustments could be made to operations and product design to enhance impact.⁷⁰

CEP completed an impact study in February 2006 using two methodologies. The first tracked the well-being of clients on a longitudinal basis, at three separate points in time. A longitudinal method allowed them to understand how the well-being of client households had changed over time in relation to the type of loan product. The second methodology was cross sectional and examined how microfinance resulted in changes in poverty levels and well-being depending on loan cycles.

CEP analyzed 11 different indicators related to household poverty levels including household income, dependency ratios, housing conditions and food security. The survey instrument also examined indicators related to children’s education, women’s empowerment, and likes and dislikes of the CEP microfinance program. When relevant, they examined causes for program drop out. The main tools used were a quantitative survey and a dropout survey.

⁷⁰ For information on two impact assessment, refer to Section VIII. Further Information.

6.1 Poverty Measurement

Some MFOs in Viet Nam use poverty measurement methods to target their microfinance services to poor clients. Dong Trieu Credit and Savings Fund, a member of the M7 Network, uses a combination of the Housing Index and Wealth Index development by CashPoor. The housing index takes into account (a) the size of house, (b) the construction material used for the walls, (c) the material of the roof, and (d) the source of running water. The Wealth Index takes into account the different assets owned by the household, such as (a) production equipment and machinery, (b) the number and kind of livestock, (c) the type of furniture in the house, and (d) the type of vehicle used for transportation. Usually, the organization selects the bottom 50% as per the indices as the initial clientele base, subsequently expanding to reach the medium poor households.⁷¹

CEP uses a point-system to calculate a poverty index to determine the poverty classification category of their clients. The poverty index is divided into moderately poor, poor, and poorest. The points are assigned based on (a) dependency ratio, (b) average household income, (c) household assets, and (d) housing index. CEP focuses on reaching the poorest and poor clients and in their 2007-10 business plan they include client impact as a key indicator of success, in particular to reduce the number of clients classified as “poorest” after two loan cycles.⁷²

⁷¹ Nhu An, Tran. “Efficiency, Financial Performance and the Role of Public Policy – a Survey of Conditions for Financial Self Sufficiency of MFIs. Survey II: Dong Trieu Credit and Savings.” December 2004.

⁷² CEP Business Plan 2007-2010.

Table 22. An example of CEP Impact Indicators and Main Findings, 2005.

Indicator	Change
Household Income	Client households have significantly increased their incomes since joining the CEP program. The average per capita household income among weekly clients after 43 months in the CEP program increased from \$0.70 per day on entry to \$1.53 per day in December 2005. For daily clients the average per capita income increased from \$0.94 per day on entry to \$2.01 per day in December 2005, and the monthly client per capita household income increased from \$0.98 to \$1.74 per day over the same period.

Information for this section is derived from CEP’s Impact Assessment of the Microfinance Institution, Ho Chi Minh City, February 2006.

7. Challenges and Opportunities

Despite advancements in the legal and regulatory framework which may open a window for the creation of licensed MFIs, there are still many structural and operational challenges facing the sector. These will limit its scale and outreach in the short and medium term. Some of the main challenges facing the industry include:

- › The absence of an enabling policy framework for microfinance has hampered and fragmented the industry for many years, because microfinance as a sustainable financial service business approach targeting the poorest segment of society is not well established in Viet Nam. There is still a widespread tendency in Government 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. On the other hand, some stakeholders agree that sustainable microfinance institutions must be able to finance growth and expansion from revenues, rather than external funding, and should be recognized as an important subsector of the financial system under the purview of the State Bank. This inherent political discord continues to restrict the industry from attaining its full potential. A policy embracing the double bottom-line (substantial outreach to BOP and financial sustainability) is necessary to provide a roadmap for industry growth, and it is encouraging that an SBV project is considering this important step, which should be underpinned by public education on good microfinance practices.
- › In this context, a smooth transition to a new role as facilitators rather than providers of microfinance for mass organizations is imperative. For many years, the MOs have managed, controlled, and implemented microfinance programs providing important services to their members and creating jobs and funding for their huge national member networks. MOs will continue to be an important part of the social fabric in Viet Nam, and are excellently placed to mobilize and link poor members to sustainable financial service providers and to provide non-

financial services, but their broad social agenda and political affiliation do not present advantages in the competitive and specialized role as microfinance providers. In addition to the political consent required around a new and less involved role for the MOs, it is also necessary to address the more mundane questions of alternative sources of funds for the MOs. It is encouraging that VWU has contracted technical assistance to review its options and develop a sound strategic plan for its future role.

- › As a result of the limited understanding of microfinance and the inherent ideological divide, there is no level playing field in the supply of microfinance in Viet Nam. The existence of VBSP which charges unsustainably low interest rates, is tax-exempt, and is guaranteed by the government, the controlling role of the MOs and the slow deregulation of interest rates implicitly limits the development of a vibrant and sustainable microfinance industry. Without a level playing field, both existing and potential new microfinance providers will find it unattractive to work, and difficult to compete in the Vietnamese microfinance market, ultimately limiting the access for poor and low-income people to appropriate and much needed financial services.
- › Decree '28/165' is a window of opportunity, but this legislation has many limitations which may not result in a dramatic change in the sector or pave the way for new entrants. At the moment, stakeholders anticipate that two MFOs will transform, but the SBV has not yet issued the operational guidelines for licensing, which are imperative as the 10 December 2008 deadline for application appears to remain fixed. The decreed requirement of foreign minority ownership may deter some equity investors.

- › The vast majority of MFOs in Viet Nam have weak governance and ownership structures, weak operations, and are not financially sustainable due to their limited outreach. This affects their ability to develop and offer diversified financial products to meet demand, and harms their chances of successfully applying for an MFI license.
- › Despite a huge demand from MFOs for training, TA, and other business support services, the domestic market of training and TA suppliers specialized in microfinance is very limited and needs to be addressed by private sector-led development of commercially viable business services.
- › The provision of microfinance services is fragmented and coordination among the many stakeholders remains 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 are not members. The PCFs have established their own association, in which the MFOs are not members. The semi-formal MFOs, but not VBSP, are part of the Microfinance Working Group (MFWG), where the MOs are surprisingly inactive. Informal coordinating channels do exist, but generally there is little direct contact and coordination between the semi-formal and the regulated providers who serve the same market, and therefore there is little agreement on basic business definitions, standardized monitoring/success indicators, accounting standards, or market information sharing to increase transparency and strengthen the industry. With an upcoming interest in SBV for a national policy for microfinance, it is imperative that communication is enhanced, consensus forged, and agreements reached on how to most effectively advocate, educate, and transparently inform policymakers on the achievements and constraints of the industry.

- › For this process to be successful, it is equally important that resident and foreign donor agencies adopt a more appropriate role as Good Practice Funders in the crowded and fragmented market. Viet Nam is an attractive donor and investor market, but lack of coordination, coherence and attendance to good practices has impeded sustainable development. Rather than distorting the market and crowding out private capital by channeling low-cost funds through banks and policy lenders to meet social goals, donors should promote the development of a healthy, sustainable, and market-led financial sector while facilitating social impact among the poorest segments of the Vietnamese population through alternative channels, e.g. MOs.

Despite these challenges, the microfinance industry has made significant progress in a positive direction over recent years, and several opportunities present themselves for further development and exploration:

- › The issuance of decrees 28 and 165 will most likely result in the formation of at least two licensed MFIs in Viet Nam. CEP and TYM may serve as examples, providing a demonstration effect for smaller MFOs to follow.
- › Prudently, some smaller MFOs will focus on growth, professionalization, and institutional strengthening before applying for a license, and the revised decrees now support this gradual move. Some MFOs are registering as Social Funds and plan to transform into licensed MFIs under Decree 28/165 in the future once they meet requirements, including five of the M7 members that are already social funds and SC US Thanh Hoa, which is transforming into a Social Fund. In this process, these new funds will continue to require external funding and technical assistance.

- › Licensed MFIs with a formal legal structure, and clearer ownership and governance systems, will have more opportunities to borrow from local and international sources. More microfinance investors appear to be watching the Vietnamese market and efforts such as Planet Finance's Investor Matchmaking Event in August 2008 are excellent opportunities to establish contacts and create linkages.
- › Formal financial providers and MFOs have demonstrated that they are willing to innovate, develop, and pilot new products. There remains a financing gap in the market, in particular for the "the missing middle" of low-income but non-poor households and small businesses that has not yet been met. The recent price increases and interest hikes in the financial sector may temporarily increase the demand for microfinance as more people, especially in the urban areas, will need financial services to see them through what is hopefully a short-lived period of hardship. For technically savvy MFOs focused on serving the poorest, the design, development, and testing of products appropriate to the needs of ethnic minority communities in Viet Nam is another opportunity for growth in a market segment with limited competition.

- › Recent discussions between SBV, AFD, and CGAP indicating that plans may be underway to draft a national microfinance policy and strategy presents a prime opportunity for all stakeholders in the microfinance industry of Viet Nam to shift the perspective from the politically ingrained divergence between charity-based poverty reduction and profit-orientation that has held back the industry, to a new consensus embracing the 'double bottom-line' of inclusive access by all poor people to sustainable financial services in line with the global Good microfinance Practices.

Even with a successful 'operationalization' of the new legal framework, the crowded microfinance market in Viet Nam, which remains distorted by subsidized lending, leaves little room for providers that may be historically or structurally disadvantaged by diluted focus, scattered outreach, and limited skill. For access to microfinance to be enhanced in Viet Nam, there is a need for providers to strengthen, adapt, adjust and innovate their products and deliver systems to respond to the changing market demand. The bar is high, and getting higher, and closures, consolidations, and mergers should be expected as potentially successful microfinance institutions distinguish themselves in this emerging industry.

8. Further Information

To learn more about microfinance in Viet Nam:

- › ABD Institute: *Managing Capital Flows: The Case of Viet Nam*, May 2008.
- › Capital Aid Fund for Employment of the Poor (CEP). "An Impact Assessment of the Microfinance Institution Capital Aid Fund of the Poor (CEP)", February 2006.
- › DFC/World Bank, Viet Nam: *Developing a Comprehensive Strategy to Expand Access (for the Poor) to Microfinance Services – Promoting Outreach, Efficiency and Sustainability*. February 6, 2007.
- › Doan Anh Toan: "Viet Nam's New Law on Microfinance: On the Way to an Enabling Environment." *Essays on Regulation and Supervision*, December 2005.
- › Franckiewicz, Cheryl: *Expanding Access to Insurance and Savings Services in Viet Nam*. International Labor Organization, 2007.
- › IFC: *Financial Sector Diagnostic, Viet Nam*, July 2007.
- › Mai Lan Le & Nhu An Trang: *Entering a New Market: Commercial banks and Small/Micro Enterprise Lending in Viet Nam*, ILO Viet Nam Working Paper Series No. 3, 2003.
- › TYM's Mutual Assistance Fund: *Viet Nam, CGAP Working Group on Microinsurance Good and Bad Practices Case Study No. 3*, June 2004.
- › TYM@15: *Heading Client Voices for Improved Practice and Stronger Impact*. TYM Research Team and CARD MRI Research Unit, September 2007.
- › USAID, *MicroNote # 35: "Habitat for Humanity in Viet Nam Partnering with MFIs to Improve Housing for the Poor"*, April 2007.