

TOWARDS DEVELOPING VIETNAM'S SUSTAINABLE MICROFINANCE SECTOR FOR POVERTY REDUCTION



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TABLE OF CONTENTS

3	ACKNOWLEDGEMENT	18	V. ACHIEVEMENTS OF MICROFINANCE SECTOR 1 Improving the provision of financial services for the poor 2 Socio-economic impacts 3 Attracting the attention of donors and global microfinance practitioners.
4	LIST OF ABBREVIATIONS	26	VI. CONSTRAINTS AND DIFFICULTIES FOR MICROFINANCE IN VIETNAM 1 Issues related to the enabling environment 2 Internal issues of MFIs
5	EXECUTIVE SUMMARY	30	VII. RECOMMENDATIONS 1 To develop a long-term microfinance development strategy 2 Things needed do immediately
11	I. INTRODUCTION	33	ANNEX 1
11	II. MICROFINANCE CONCEPT	34	ANNEX 2
12	III. HISTORY OF MICROFINANCE IN VIETNAM		
15	IV. MICROFINANCE AND MICROCREDIT SERVICE PROVIDERS		



ACKNOWLEDGEMENT

Microfinance has been introduced to Vietnam for 2 decades, through different channels and different approaches. Up to 300 microfinance projects are spreading throughout the country. Despite the small scale and the fragmentation, these microfinance projects have reached the poor and the poorest, especially women and ethnic minority people living in remote and mountainous areas. At present, more than 500,000 poor people are joining microfinance projects not only to borrow but also to build up their assets, to change their mind-set and to form new value through the active participation in the project and ultimately to change their status. This is the microfinance approach that makes such value added contribution. At least a half of them have escaped from poverty and led a better off life. At least 1,000 full-time and part-time officers have been hard-working and patient to bring microfinance to the poor, especially women and ethnic minority people, making a considerable contribution to the national socio-economic development.

In this short paper, despite my effort, I can not write down all achievements that have been made, all difficulties that have been encountered and all expectations that come from different perspectives.

However, in order to write this paper, we have received the valuable supports of leaders of M7, CEP, TYM, VBCP, MFWG, Thanh Hóa Microfinance, Binh Minh, of experts of CARE project in Bắc Cạn, Hòa Bình, WUs in Đại Từ, Thái Nguyên, Project of CRD in Phú Thọ, Project in Bến tre ...and especially the participation in the questionnaire interview of nearly 3,000 members of M7, the hard-working and intense working of M7 officers in this quick survey.

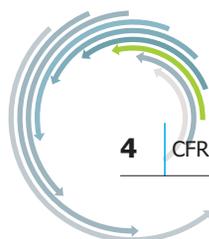
We would like also to express our thanks to Dr.Kim Anh, Deputy Director of the Banking Academy, who encouraged and provided useful suggestions for us to complete this paper.

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LIST OF ABBREVIATIONS

ADB	Asian Development Bank
BTC	Belgian Technical Cooperation
CEP	Capital Aid Fund for Employment of the Poor (of HCMC Labour Confederation)
CGAP	Consultative Group to Assist the Poor
CIDSE	Cooperation Internationale pour le Developpement et la Solidarit
CRD	Center of Rural Development
CRS	Catholic Relief Service
CSOD	Center for Social Organization Development
DFID	Department for International Development
FAO	UN Food and Agriculture Organization
FINCA	Foundation for International Community Assistance
INGOs	International Non-Governmental Organizations
WU	Women's Union
MFI	Microfinance Institution
SBV	State Bank of Vietnam
CWU	Central Women's Union
SCUK	Save the Children UK
SCUS	Save the Children US
SIDA	Swedish International Development Agency
MF	Microfinance
The MIX	Microfinance Information
TYM	Affection Fund
UNDP	UN Development Program
UNFPA	UN Population Fund
UNICEF	UN Children's Fund
VBARD	Vietnam Bank for Agriculture and Rural Development
VBSP	Vietnam Bank for Social Policy
WB	World Bank



EXECUTIVE SUMMARY

I. INTRODUCTION

Microfinance has played an important role in achieving targets of Vietnam's National Poverty Reduction Program. Two decrees numbered 28 (2005) and 165 (2007) on organization and operation of microfinance institutions have been issued to provide a legal framework for microfinance activities. The implication of the two decrees, however, has failed people's expectations. In September 2009, the Prime Minister established the Microfinance Working Group by the decision 1450/QĐ-TTg, expressing the determination to promote this industry. In order to help improve understanding and facilitate more proper assessment of microfinance situation in Vietnam, this paper would like to provide some fundamental information about microfinance, its development, achievements, and challenges encountered. Alongside with this, this paper would also propose some recommendations for the reference of policy makers, relevant regulators, and academics in making decisions related to microfinance, hoping it will somehow contribute to the development of microfinance and the cause of hunger alleviation and poverty reduction of Vietnam.

II. DEFINITION OF MICROFINANCE

Microfinance in an old definition is providing small, short-term loans without requirements of collateral and interest payment (ROSCA). Very high interest rate may be charged in case of emergency borrowings that are not met by formal lenders. This out of date definition has misled thoughts of many with the interpretation that (1) without interest payment means supports, and (2) high interest rate means exploitation and cannot go with social goals.

However, from financial views, microfinance is defined as *"a credit method effectively replaces collateral requirements in allocating and collecting short-term production capital for small entrepreneurs (or potential entrepreneurs), with the views that economic conditions of small entrepreneurs will be improved, creating income and sometimes jobs, helping poor people to escape poverty"*⁽¹⁾.

Through many years of implementation and experiences, microfinance practitioners and donors have learnt the lesson that: (a) Microfinance requires institutional sustainability with proper organization, staff structure, and operational procedures; (b) Microfinance requires a legal personality with a legal environment ensuring a competitive position and playing field; and (c) the poor needs more financial services than just credit (e.g. savings, money transfer, and insurance). Basing on that, CGAP has defined microfinance as *"Microfinance offers poor people access to basic financial services such as loans, savings, money transfer services and microinsurance and other non-financial services with a suitable mechanism that helps supporting production, job creation and income generation for improved quality of life of low-income people"*⁽²⁾.

Interest rate is not the top concern of the poor in considering credit choices but the way in which services are delivered and procedures that are simple, quick, and convenient, facilitating them to grasp investment opportunities. Experiences show that high interest rate will increase repayment responsibility of borrowers, forcing them to consider business plans carefully, plan incomes and expenditures. That is family's budget planning, and is the value added by microfinance: development of quality human resources..

(1). CGAP Phase III Strategy, 2003-2008.

(2). www.cgap.org



III. HISTORY OF MICROFINANCE SECTOR IN VIETNAM

Microfinance has penetrated in Vietnam for 2 decades in many forms and approaches. The most common one is savings-credit projects or the credit component in integrated rural development projects of INGOs, international organizations, or bilateral projects targeting certain groups in project sites. Local partners of such projects are mass organizations, professional associations, etc., among them Vietnam's women union is the major one with a nation-wide grassroots network. Microfinance programs have established the partnership at all four levels of the women union, facilitating the nation-wide extension of microfinance activities in Vietnam with various sizes and management mechanisms (this also makes microfinance in Vietnam become more diversified).

As with international microfinance activities, microfinance in Vietnam has its own ups and downs, difficulties, and deviation due to the different levels of awareness. In first stages, it had a slower pace but it can gain higher one in later stages if having the right moves.

The development history of microfinance in Vietnam can be divided in 3 stages: introduction, expansion, and in-depth development.

a) Introduction stage (before 1980s)

In traditional ways, microfinance has been with people for a long long time, rooted in a small agricultural and self-sufficient economy and communal life styles. It has little impacts on economic development but significant roles in helping people and households encounter sudden risks that threaten their life and push them to extreme difficulties.

b) Rapid expansion (1990 – 2000)

By the end of 1980s, after 30 years of experiences in Bangladesh, Brazil, and some other countries, it has been found that the poor is fully capable of banking. In these years, microfinance made its first steps into and then rapid expansion in Vietnam. Several projects funded by INGOs and international organizations, and bilateral projects with different pilot models taken place in Vietnam. They are mainly in 3 forms:

- Projects specialized in providing savings-credit services to poor women. They are usually funded by INGOs through women unions as the partner. Some of them are designed under international practices with the aims of self-sufficiency.
- Integrated rural development projects combining credit services with other components, such as education, healthcare, shelter, water, and environment, etc., credit component plays just a small role. They are usually funded by international organizations with social targets, implemented in a short period then concluded.
- Partnership between mass organizations (Vietnam Women's Union) and a commercial bank (Project VIE 91/P01, partnership between VBARD and Vietnam Women's Union). Under this partnership, the commercial bank lends through women's savings groups which are set-up and managed by women's unions. The loans are granted with group's prestige guarantees instead of collateral. After 3 years of success, this pilot model was officially prescribed in Decree 14 by Government on lending to farmers without collateral.

In general, international organizations in Vietnam have played a crucial part in creating foundation for the development of microfinance in Vietnam. They have provided considerable resources and set the stage for local organizations to continue. Donors and foreign microfinance institutions also make significant contributions in terms of finance, technician assistance, and training.

c) In-depth development (after 2000 up to now)

By the beginning of 21st century, microfinance is no longer the 'fashion' of the world. In Vietnam, projects' and programs' microfinance component is gradually concluded. This is a very difficult time for microfinance organizations. In such context, MFIs have tried their best for survival; some of them establish social funds under provisions of Decree 177-1999/ND-CP on organization and operation of



social funds and charity funds (it then replaced by Decree 148-2007/NĐ-CP). This legal framework, however, still poses several challenges to microfinance operations.

In 2005, the Government issued Decree 28-2005/ND-CP and then Decree 165, creating a legal framework for microfinance but the implication of the two decrees is very slow due to their limitations. It has been 5 years since the issuance of the Decree 28 but there is no MFI being licensed and only 3 applications (CEP, TYM and M7) awaiting the procedure to run.

IV. MICROFINANCE AND MICROCREDIT SERVICE PROVIDERS

When commenting or assessing microfinance, it should be born in mind that microfinance is different from small-scale credit services. From the general legal views and supervision by SBV, microfinance can be classified into 3 groups:

Formal (providing small-scale credit services)	Semi-formal (mainly microfinance services)	Informal (credit-savings)
<ul style="list-style-type: none"> ● Vietnam's Bank for Agricultural and Rural Development (VBARD) ● People's Credit Funds (PCPs) ● Vietnam Postal Savings Company (VPSC). ● Vietnam's Bank for Social Policies (VBSP) 	<ul style="list-style-type: none"> ● Some international non-governmental organizations. ● More than 50 MFIs, including social funds specialized in microfinance. ● Hundreds of projects and programs providing small-scale credit or microfinance services implemented by Women's unions. 	<ul style="list-style-type: none"> ● Ho/Hui (ROSCA) ● Relatives, friends, neighbours ● Private money lenders

Semi-formal sector

According to Viet-Bi credit project of Vietnam women's union and data collected from MFIs, there are now more than 300 microfinance projects throughout the country at various scale with about half a million of members. This figure is so modest in comparison with nearly 6 million poor households being served by VBSP. "However, these MFIs aim to serve the poor in rural and remote areas where formal financial institutions are not capable or ready to reach⁽³⁾. However, these MFIs usually rely on international donors's fundings for expansion and haven't had any legal personality to access commercial sources of financing."⁽⁴⁾

V. ACHIEVEMENTS OF MICROFINANCE SECTOR IN VIETNAM

This paper will demonstrate only achievements of semi-formal sector.

1. Enhancing financial services for the poor

1.1 Establishing and developing a system providing financial services for economically disadvantaged households.

With nearly 20 years of implementation, microfinance in Vietnam has had a network specialized in servicing the poor. This network is continuously adjusted to international practices and experiences of best microfinance institutions.

1.2 Providing dynamic microfinance services to meet diversified needs of poor and low-income households..

The dynamic and flexible characteristics of microfinance is rooted in its philosophy of equal

(3). Major targeted customers of MFIs are: (a) poor households; (b) ethnic minorities; and (c) households living in remote and disadvantaged areas.

(4). According to the Decree No.28 on the organization and operations of MFIs, the licensed MFIs shall be entitled to receiving trust funds and investment funds from both individuals and organizations.



opportunities for everyone. Savings products are to help the poor accumulate assets before accessing credit. Microinsurance products are to protect benefits brought to the poor by microfinance and also to protect the safety of the MFI.

2. Social and economic impacts

2.1 Contributing to the cause of hunger alleviation and poverty reduction, creating jobs, diversifying sources of income, and improving living standards.

Several impact assessments have revealed that proportion of the poor graduating from poverty within members of MFIs is higher than that of non-members. Situation in terms of shelter, nutrition, expenditures, and education of children is improved.

2.2 Encouraging the participation and contribution of the poor to the economy.

Microfinance has motivated potentials of the poor. With loans that are small, short-term, rotating and gradually increasing; payments and repayments in installments with low interest rate, microfinance has made the poor more active, confident, contributing to the diversified development of the economy.

2.3 Improving resources, and enhancing community relations.

The rotating leadership mechanism in groups and clusters accompanied with regular meetings and visits among members not only enrich members' knowledge and skills but also enhance their capacities, facilitating the experience exchange and bonding relations.

2.4 Empowering women.

That programs are for women helps them develop their potential, creating good impacts within families and throughout the society.

2.5 Building capacities for mass organizations.

Microfinance provides management skills for partners, helps them upgrade themselves.

3. Drawing attention of donors and organization having microfinance activities around the world.

Microfinance in Vietnam has a close relationship with international microfinance. After the Vietnam's accession to WTO, many organizations have joined The MIX, a useful information channel for donors, investors, policy makers, and MFIs. A new relation between Vietnam's microfinance practitioners and international donors and investors is established, that is the cooperation in the process of commercialization of microfinance in Vietnam.

VI. CONSTRAINTS AND LIMITATIONS FOR MICROFINANCE SECTOR IN VIETNAM

There are obstacles limiting the development of microfinance in Vietnam in terms of outreach and financial sustainability. They can be classified into two groups: (a) External challenges of the business environment, including Government's roles, legal framework, and relevant policies, (b) Internal challenges of microfinance service providers.

1. Issues of the business environment

1. There are gaps from the awareness of microfinance of the Government, functional authorities, and MFIs to the international standards.

2. VBSP with its current operation is a direct challenge to microfinance activities.

3. There is a lack of microfinance strategy.



4. Policies on microfinance at the first stage with inconsistency and non-synchronism

5. There is no policy and mechanism mobilizing resources for the development of microfinance.

MFIs are “tied”. In one hand, in accordance with current regulations (1) MFIs are not allowed to mobilize voluntary savings, (2) the proportion of savings to institutional capital should be less than 50% (regulations by SBV)⁽⁵⁾, while the recommendations under international standards is that the proportion of savings to outstanding loans should be 70%-80%; (3) MFIs have no access to soft loans from WB, ADB, or development bank; (4) MFIs have no access to funding from national programs which have the same target population as MFIs; (5) MFIs are not allowed to borrow from foreign sources under Decree 134 because they are not business entities.

Financing is the determinant of microfinance’s viability but at the time being all ways to finance resources are obstructed. Removing such obstacles can make half of the future success of microfinance in Vietnam.

6. SBV’s human resources in terms of microfinance management is limited.

SBV is in the process of restructuring both in terms of organization and personnel. Its human resources set aside for dealing with microfinance-related matters is very limited and keep changing. This makes the processing of microfinance issues slow, late, creating even more obstacles for microfinance.

2. Internal issues

2.1. Limitations of MFIs

- Limitations in MFIs’ awareness of microfinance slow the process of transformation to professional operation.
- There is no master model of organization. With different history of development, MFIs have different organization model, requiring for a restructuring under a master model for all.
- Human resources lack management skills. This is the major obstacles to MFIs, affecting the full development of microfinance in Vietnam
- Limited training facilities. There is still no complete MIS. The task of developing and implementing such MIS is a great challenge to MFIs in terms of costs and human resources. Although there are many materials from CGAP and successful MFIs in and out of Vietnam, there is no standardized microfinance training manual for Vietnam.
- Severe shortage of capital

2.2 Limitations in relations among MFIs

- There is a lack of cooperation between MFIs. Number of MFIs with strong organization and human resources is too limited to set up a network representing Vietnam’s microfinance community.

VII. RECOMMENDATIONS

1 A long-term development strategy for microfinance

Followed the decision 1450 QD-TTg on establishing the Government’s microfinance working group, it is required to have a detailed plan and process with timeframe for each goal in each period. The assistance to the working group in developing such strategy requires personnel who have knowledge of and skills on designing legal documents, understanding of macro-economic, finance and banking, and microfinance development strategies.

1.1 Harmonizing mainstream directions on microfinance. To have a good and feasible strategy, the first task should be completed is to harmonize mainstream directions on microfinance in Vietnam: (1) Clarifying the target of hunger alleviation and poverty reduction in national social economic

(5). Prescribed in Decree No.28/2005/ND-CP



development strategy; (2) MFIs have the mission of providing microfinance services in the efforts toward the common target of hunger alleviation and poverty reduction; (3) MFIs are social businesses but needs to be financially sustainable; (4) Target groups/areas of microfinance are the poor and low-income people, and certain population in accordance with conditions areas facing poverty and difficulties; (5) MFIs can be for-profit or non-profit and be regulated respectively; tax should be exempted in case of non-profit MFIs and applied differently in case of for-profit MFIs; (6) Don't apply interest ceiling to microfinance services due to its features of high costs (management of small loans required higher costs) and social mission; (7) Government's supports should be focused on creating favorable conditions for the development of microfinance instead of direct interventions and subsidized credit; (8) Creating favourable conditions for MFIs to get access to sources of capital; (9) Encouraging training organizations to develop code of management and external evaluation regarding microfinance activities; (10) Encouraging MFIs to establish their own network toward the establishment of amicrofinance association.

1.2 Expanding representatives in Government's microfinance working group. The microfinance working group should have additional representatives from Vietnam's Labour union, and microfinance practitioners from urban areas (CEP), rural areas (TYM), and mountainous areas (M7 network). The absence of such representatives will be a detriment of feasibility of the strategy and relevant policies.

1.3 Conducting surveys on, getting comprehensive data about current situation of MFIs. Mobilizing current networks like microfinance practitioners' microfinance working group, M7 network, or other capable organizations to join the process to get preliminary data to feed in the planning process.

1.4 Reviewing current policies on subsidized credit. It is required an independent, objective, and straight assessment in order to find a solution for changes needed.

1.5 Designing microfinance development strategy for the next 10 years

2 Urgent issues

2.1 Building capacities for SBV in terms of supervising microfinance activities and implementing Decree 28/165. Along with the task of developing a development strategy for microfinance, it is essential to build up microfinance supervision capacities. Training about principles of microfinance should be conducted throughout the supervision system, including domestic and abroad courses. International consultants may be needed in certain issues. The licensing process should be sped up. This will provide more experiences to feed in the development strategy.

2.2 Allowing MFIs and MFI-supporting organizations with independent legal personality to borrow from foreign sources. This is crucial because the capital shortage of MFIs will lead to the loss of clients' confidence and group leaving, eventually leading to organization dissolution.

2.3 Removing interest ceiling for MFIs. MFIs obviously bear high costs for managing small loans, building capacities and assets for poor people, helping them protect assets. On the other hand, MFIs also need to be self-sufficient to develop and expand outreach. Moreover, given the service quality of MFIs, poor people accept such high cost.

2.4 Supporting the transformation to legal MFIs. Given the scarcity of resources and limitations of experiences, supports should be focused on key matters such as harmonizing microfinance-related policies, process and procedures. It had better make the best use of experiences and resources of large MFIs, and qualified technical assistance providers in Vietnam.

2.5 Building infrastructure for the development of microfinance in Vietnam. It is support for MFIs in terms of information management system (MIS), office location, and equipment.

2.6 Exempting income tax for MFIs until there is a master strategy and comprehensive policy package for the development of microfinance in Vietnam.



I. INTRODUCTION

Over the last 2 decades, microfinance has played an important role in achieving goals and targets of the Comprehensive Poverty and Growth Strategy. The Government issued Decree No.28 (2005) and Decree No.165 (2007) on the organization and operation of microfinance institutions in order to establish the legal framework for microfinance. However, the implementation of these Decrees has not been up to the general expectation. On the 16th September 2009, the Prime Minister signed the Decision No. 1450/QĐ-TTg to set up the Microfinance Working Group which indicated the determination to develop the microfinance sector. However, in order to develop in the right direction and to attain expected results, it is necessary to have a proper understanding of microfinance, its unique features and development path as well as appropriate measures. In this paper, we would like to introduce the most essential elements of microfinance, its history and developments in Vietnam, achievements and difficulties encountered and also to make recommendations for the consideration and reference of policy-makers, State Management Agencies and academic community in the process of making decision on the right development of microfinance towards the achievement of poverty reduction goals in Vietnam.

II. MICROFINANCE CONCEPT

According to the conventional definition, microfinance is deemed as small scale, uncollateralized, interest rate free (ROSCA) or very high interest rate (hot loan) lending extended to those who urgently need to borrow but are unable to borrow from formal money lenders. This conventional concept has affected the mindset of a portion of people who often think that, (1) lending to the poor should be interest rate free or with preferential rate only, (2) the high interest rates are exploitive in nature and thus do not make social sense, etc.

However, in the finance-banking perspective, microfinance is defined as *“credit method selected to replace collateralized lending, for delivery and collection of short-term loans, production loans for microenterprises (or potential microenterprises) with recognition that microenterprises will grow, generating for their own and also creating more jobs, lifting poor people out of poverty”*⁽⁶⁾.

After years of experience, microfinance practitioners and donors have withdrawn the following lessons: (a) Microfinance needs the institutional sustainability with a properly functioning operational system, processes and staff; (b) Microfinance requires the transformation into legitimate institution and enabling legal environment in order to ensure a level and competitive playing field; and (c) the poor demand more financial services such as savings service, money transfer and insurance services rather than the sole credit product. According to CGAP’s definition, *“Microfinance is the provision of credit, savings, microinsurance, money transfer services and other non-financial services to the low-income households through an appropriate mechanism, enabling them to conduct production and income-generating activities for improved quality of life”*⁽⁷⁾

For the poor, the lending interest rate is not the most important. Instead, the quick and convenient delivery of service is the most important because it enables them to grasp good investment opportunities. Lending interest rates of microfinance institutions are often higher than those of commercial banks (about 1 – 2 %/month). The high interest rates enhance the repayment responsibility of borrowers, pressing them to make careful revenue and consumption plans, this is the household budgeting processes which is the value added of microfinance: development of a quality human resource. Small loan size enables borrowers to manage and repay their debts in an easier way while the high interest rate enables the microfinance service providers to cover the high cost of extending loans to the poor. International experience has shown that (a) the poor appreciate the access to credit and is willing to pay additional cost for this access; (b) microfinance programs needs to set the interest rates at such levels that are able to cover the appropriate operational expenses so that the provision of lending service is more sustainable and more regular; (c) lending interest rates of microfinance institutions are still lower those offered by informal private money lenders (about 5 – 10%/month).

(6). CGAP Phase III Strategy, 2003-2008.

(7). www.cgap.org



In terms of loan use, the M7 Microfinance Network's survey of borrowers with loan amount exceeding VND10,000,000 (in November 2009)⁽⁸⁾ indicates that, 39% of loans are used for trading; 30% of loans are used for house renovation/construction, 18% for aquaculture, 8% for purchase of assets and only 5% for cultivation. Whereas, in the case of bank loans, 54% are for production and business, 19% are for housing and living improvement, 11% are education and health care, and 11% for meals and other consumptions⁽⁹⁾.

III. HISTORY OF MICROFINANCE IN VIETNAM

Microfinance was introduced to Vietnam in the late 1980s through different channels and approaches, and mainly by ways of credit-savings projects or credit component of integrated development projects funded by international non-governmental organizations (INGOs), international organizations (FAO, UNFPA, UNDP, WB, ADB...) or bilateral donors (BTC, SIDA ...) and with targeted beneficiaries in their selected areas. National counterparts of these projects were mainly political-social mass organizations, professional associations, etc. in which the Vietnam Women's Union (VWU) was the biggest partner with the local networks to the grassroots levels throughout the country. All four levels of WU have been involved in credit-savings projects as partners, making the microfinance activities spread to all regions of Vietnam with variety of scales and development levels which contribute to the diversity and segmentation of microfinance in Vietnam.

As a result of the general development of microfinance in the world, microfinance in Vietnam has experienced ups and downs and encountered difficulties and challenges similar to other countries. A possible difference is the slower pace in the initial stage and faster pace in the later stage if good policies are introduced.

The development of microfinance in Vietnam can be divided into 3 stages: initial, expansion and in-depth development.

a) Initial stage (before 1980)

Just like other countries in the world, as conventionally defined, microfinance in Vietnam was interpreted as collateralized or uncollateralized, interest rate free or high interest rate small loans. With such definition, it can be said that microfinance emerged and existed in Vietnam for quite a long time and was attached to the small scale agriculture and the daily village affairs of people in all regions, especially those in the country-side. While its contribution to economic development was modest, it plays a big role in supporting households and peoples who faced adversities and difficulties that endangered their lives and were likely to put them in the disastrous situations.

b) Rapid expansion (1990 – 2000)

In the late 1980s, after 30 years of rolling out in Bangladesh, Brazil and some other countries, it was discovered and confirmed that the poor were fully bankable. Like other people, the poor need a variety of financial instruments to build assets, to smooth daily consumption and to protect themselves against risks that can occur anytime. During these years, microfinance was first introduced to Vietnam. The Asia-Pacific International Conference on "employment and income generation for women" hosted by VWU in Hanoi in October 1987 was the starting point for credit-savings projects dedicated to women. The Swedish International Development Agency (SIDA) in Vietnam was the first donor that funded a credit project (1989) for women in 7 Northern borderline provinces through WU as the local partner. The UN Population Fund (UNFPA), together with FAO as technical assistance provider, coordinated with the Central WU and the Vietnam Bank for Agriculture (1990-1993) to pilot the project VIE/ 91/ P01, in which the bank provided non-collateralized loans to women through women's savings groups set up by WU in Hau Giang province (now Can Tho) and Ha Son Binh (now merged with Hanoi). After 3 years of successful piloting, the Vietnam Bank for Agriculture integrated the term WOMEN'S SAVINGS GROUP into the

(8). Results of surveys in Ung Bi, Dong Trieu and Mai Son of M7 CFRC

(9). Results of VHLSS 2006 of GSO



Government's Decree No.14 on the non-collateralized lending to peasants. UNFPA continued phase 2 of the project which aimed at expanding to 18 provinces in Vietnam.

During 1990s, development agencies of some countries such as SIDA (Sweden), DFID (UK), BTC (Belgium), international development organizations such as UNDP, UNFPA, UNICEF, and INGOs implemented a number of credit-savings projects. INGO-funded projects with the scale of 10,000 members and above were those of Save the Children UK (SCUK), Action Aid International in Vietnam (AAV). The microfinance service delivery models of these organizations were very diverse because the objectives and approaches of these organizations were different. Big projects funded by international organizations and bilateral projects often considered microcredit as a component factor to promote social interventions such as family planning, life skill education, environmental sanitation, etc. Projects funded by INGOs were often more technically sophisticated. These projects used either approaches as follows: (1) modified Grameen bank method or (2) modified village banking method. Among various models, the 2 layer organizational structure of a microfinance project was considered as appropriate and convenient for good management. Projects of AAV, CIDSE, SCUS, CRS, OXFAM GB, OXFAM Belgium, GRET, etc. followed this model and out of these, the structure of 2 financially independent layers in AAV funded projects was assessed as institutionally sustainable, market accessibility, rapid expansion and low cost. Action Aid pursued the approach that emphasized the basic rights of the poor which included the right to credit access as an important right. After 10 years of operation (1993-2003), Action Aid established 7 two-layer microfinance service systems in 7 districts of 5 provinces, ranging from the mountainous province (Sơn La) to the coastal province (Ninh Thuận). These systems have covered 55 communes/wards and 7 district level schemes have provided the credit and savings services to more than 27,000 members. These systems were the pride of not only women from different ethnic groups but also of all related communities. Local authorities highly appreciated and recognized the positive role of these systems in terms of poverty reduction and equality among different ethnic groups.

The Save the Children UK applied the model under the direct management of commune level WU. Over 10 years, SCUK established microfinance service outlets in 16 communes of Thạch Thành district, Thanh Hóa province and 22 communes of Cẩm Xuyên district, Hà Tĩnh province with the financing source up to dozen of billions of VND. The major approach of this model is to provide non-collateralized microcredit with the binding savings.

In general, international organizations operating in Vietnam have played significant roles in laying the foundation for the development of microfinance in Vietnam. They have provided a substantial resource and created momentum for the further development of local organizations. External donors and microfinance institutions have made considerable contributions to the financial and technical support for Vietnamese staff. In as early as 1995, T.Y.M Fund participated in the Asia Pacific Savings and Credit Network for the Poor and the CEP Fund followed suit. Both funds then joined the Global Grameen network and were trained quite properly in terms of techniques and the management of microfinance institutions. Other microfinance institutions of Vietnam such as AAV funded microfinance projects have been recognized as member of the World Microcredit Summit Movement since 1997.

Influential microfinance practitioners led by Professor, Dr. Muhammad Yunus have collaborated, promoted and organized successfully the **World Microcredit Summit**⁽¹⁰⁾, that was first held in Washington DC. Up to 2,900 participants from 300 countries. International organizations, donors, INGOs and microfinance practitioners went there *"... to talk about what have not been addressed before, to make unprecedented plans and to do what have not been done before, in order to get poverty out of this planet"*⁽¹¹⁾.

The Summit initiated the microcredit movement with the objective: **"...By 2005, 100 million poor households will access to appropriate financial services in order to change their lives"**. In the plenary session of the Summit, representatives signed the commitment and the country plan of actions for achieving this objective. Official representative of Vietnamese delegation was the leader of TYM Fund of the Vietnam Women's Union. In the subsequent Summits, the representatives from Vietnam were

(10). The World Microcredit Summit Conference was held in Washington DC in February 2007

(11). The concluding remark of Mr. Samdaley Harry – chairman of the World Microcredit Summit



expanded to CEP Fund and some other organizations. Upon returning to Vietnam, these Vietnamese representatives made great efforts in promoting the development of microfinance in Vietnam towards professionalism.

c) In-depth development (from 2000 to present)

In early 21st century, microfinance was no longer “trendy” in the world development arena. In Vietnam, programs and projects with microfinance component were gradually phased out. UNICEF funded microcredit programs implemented by WU in 42 provinces stopped operating, member’s savings were returned and the revolving funds were collected and used for other purposes.. *“Many big donors have withdrawn their funds from microfinance programs, leaving behind the disappointment of the poor members of these programs”* ⁽¹²⁾

Microfinance programs of INGOs were gradually handed over to the local counterparts while the legal, institutional and ownership models were not adequate. It could be said that, this was a very difficult period for organizations operating microfinance programs. The local partners who operated the microfinance programs were not independent legal entities and thus were unable to directly take the hand-over. Organizations who directly received the handover did not had knowledge on microfinance. Besides, the legal basis for receiving the handover, especially the ownership of the program was inadequate and unclear. The administrative supervision model was no longer appropriated when it comes to microfinance. All of these difficulties have led to the contraction and diminution of many microfinance programs (UNICEF, UNFPA, CIDSE, Oxfam GB, Oxfam Hong Kong, Quaker US...). There were well-known microfinance programs such as SCUK’s schemes that diminished due to the inappropriate direction. TYM Fund, despite having a very good starting scale, was not successful in mobilizing external financial and technical resources for 8 consecutive years and therefore its expansion was constrained for quite a long time.

In this context, some organizations made substantial efforts to survive, to transform the organizational and financial structures, to strengthen the capacity and the professionalism, so that they would be well-prepared to be formalized upon the availability of the relevant legal framework. A number of social funds were established on the legal basis of the Decree No.177/1999/ND-CP on the organization and the operations of social funds and charity funds (and the revised Decree No.148-2007/ND-CP. Seven ActionAid funded savings-credit programs selected this legal basis for their transformation. As of today, there have been about 9 social funds conducting microfinance activities⁽¹³⁾. However, this legal framework still creates many constraints for microfinance. In 2006, the TYM Fund decided to transform into a revenue-generating public service organization under the umbrella of the Central WU in accordance with the Government’s Decree No.10 in order to increase its autonomy and to better reflect its full expenses and revenues in the accounting system.

Except CEP Fund established by the HCMC Labour Confederation, there are less organizations operating microfinance programs in the southern provinces. Thanks to the initial determination of clear vision and strategy, CEP has positioned itself as an independent legal entity. CEP has developed steadily with the supports from both HCMC and the central level.

Regarding the legal framework and policy, despite the fact that the Decree on microfinance had been drafted in 2002, the Government’s Decree No.28/2005/ND-CP on the organization and operations of microfinance institutions and Decree No.165 on the revision of Decree No.28 was not issued until 2005 and 2007, respectively. Due to various reasons, the guideline for implementing these Decrees was later

(12). Lê Thị Lân: *Microfinance in Vietnam – Opportunities and Challenges. Report presented in the International Conference on Microfinance organized by CEP in HCMC, May 2003*

(13). HCMC WU’s Fund for Encouraging Women’s Economic Development, Uong Bi Fund for Encouragement of Women’s Development Pro-poor Center (PPC) in Can Loc (Ha Tinh); Dong Trieu Fund for Women’s Development (Quang Ninh); Mai Son Fund for mountainous women’s development (Son La); Ninh Phuoc Fund for Women’s Development (Ninh Thuan); Assistance Fund for Women’s Development of Dien Bien Phu city (Dien Bien); Fund for poor women Thanh Hoa supporting.



than scheduled. However, the issuance of these legal documents has motivated qualified organizations such as TYM, CEP to make intensive preparation for the application for licence. In addition, 4 member organizations of the M7 Microfinance network teamed up to submit to the State Bank of Vietnam the application for licence of a single microfinance institution.

Thanks to the rapid development and the substantial impact of microfinance on poverty reduction globally, microfinance has been recognized as an effective tool for reducing poverty. The year 2005 was selected as “International Year of Microcredit”. The architect of Grameen Bank approach that has been applied successfully in Bangladesh and 110 countries in the world was co-awarded, together with Grameen Bank, the Nobel Peace Prize in 2006.

**THE YEAR 2005 HAS BEEN ANNOUNCED AS
“International Year of Microcredit”.**

In 2006, for the first time, the Nobel Peace Prize was awarded to an economist and the Grameen Bank which was founded by him.

Taslima Begum, Board directors of GB and Prof. Muhammad Yunus receive the Nobel Peace Prize



IV. MICROFINANCE AND MICROCREDIT SERVICE PROVIDERS

There should be a clear distinction between microfinance and microcredit in order to avoid possible mistakes in assessing results and making policies. Under the current overall legal framework and the regulatory framework of the State Bank of Vietnam, microfinance and microcredit service providers in Vietnam can be categorized as follows::

Formal (providing small-scale credit services)	Semi-formal (mainly microfinance services)	Informal (credit-savings)
<ul style="list-style-type: none"> ● Vietnam’s Bank for Agricultural and Rural Development (VBARD) ● People’s Credit Funds (PCPs) ● Vietnam Postal Savings Company (VPSC). ● Vietnam’s Bank for Social Policies (VBSP) 	<ul style="list-style-type: none"> ● Some international non-governmental organizations. ● More than 50 MFIs, including social funds specialized in microfinance. ● Hundreds of projects and programs providing small-scale credit or microfinance services implemented by Women’s unions. 	<ul style="list-style-type: none"> ● Ho/Hui (ROSCA) ● Relatives, friends, neighbours ● Private money lenders

A. FORMAL SECTOR

● **Vietnam Bank for Agriculture and Rural Development (VBARD).** Two banks with largest loan portfolio to the rural and mountainous borrowers in the formal sector *that provide microcredit* are VBARD and VBSP. In 2003, VBARD handed over the lending to poor households to VBSP but still implemented some credit

(14). Data in the website of VBARD and of The Mix in September 09



projects funded by ODA from international organizations and other directed credit programs of the Government. Loans of VBARD have been mainly extended to rural borrowers with better-off living standard and large businesses. Total assets of VARD amounted to nearly 482,920 trillion VND⁽¹⁴⁾, which was 1.3 times larger than those of VBSP. Its loan portfolio accounted for 77% of total assets while that of VBSP was 79%.

● **Vietnam Bank for Social Policy.** With a network of 610 branches in 63 provinces/cities throughout the country and a human resource of 7,809 staff, VBSP has extended loans to 46%⁽¹⁵⁾ of the poor in rural and mountainous areas. Since the division of target customers between VBARD and VBSP, branches of the former have no longer extended small scale loans to poor households and the branches of the latter have been in charge of this task. However, *VBSP's mechanism of using large and medium term loans as main products has created a large gap between those poor households that have not been able to borrow and those poor households that are currently borrowing but can not continue to borrow when their needs arise every day; in addition, the low lending interest rate has led to the leakage of budget resource which has already been under pressure, to some non-poor borrowers.* On the other hand, the market segmentation has unintentionally crowded out the near poor group which is quite large in numbers and out of attention of financial service providers.

● **People's Credit Funds** that have been established since 1993 appear to be modest in organizational expansion while tend to consolidate into bigger organization. The emergence of PCF system has made important contribution to the rural and agricultural lending. However, the collateralized lending approach of PCF seems not to be attractive to the poor.

● **Vietnam Postal Savings Service Company**

The Vietnam Postal Savings Service Company which was established in 1999 operates under the umbrella of the Vietnam Postal and Telecommunication Corporation. The major function of the company is to provide savings products to a portion of Vietnamese population (rural, women, the poor) in order to mobilize savings for the public development investment. The operational network of the company includes the head office in Hanoi, 5 branches in 5 key provinces/cities and the extensive sub-provincial system. Although the minimum savings amount is set at 50,000 VND for each deposit, it is still very difficult for poor households, ethnic minority households who are living far from the postal centers.

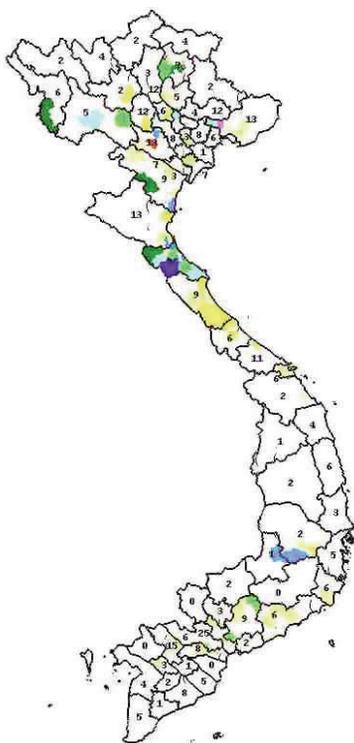
B. SEMI-FORMAL SECTOR

Semi-formal financial service providers include organizations that are established in accordance with Vietnamese laws and conducting foreign donor-funded microfinance programs. These semi-formal microfinance institutions are often considered as more pro-poor, more diverse and more appropriate in terms of financial services provided than those in the formal sector.⁽¹⁶⁾

So far there has been no agency responsible for collecting information on the situation of institutions conducting microfinance activities. However, there are some incomplete data on this. In 2001, a WB report gave a preliminary figure of 57 institutions doing microfinance. In 2008, the Vietnam Microfinance Working Group reported that there were 41 institutions. The study result of the Belgium-Vietnamese Project indicated that there were up to 301 projects with microfinance component in all provinces/cities of Vietnam.

(15). GSO Report on the results of VHLSS 2006
(16). World Bank (2003), *ibid*





MAP OF MICROFINANCE PROJECTS IMPLEMENTED BY WUs AT DIFFERENT LEVELS IN EACH PROVINCE

- According to the study result of the Belgium-Vietnamese Credit Project, there are up to 301 units nation-wide having savings-credit activities managed by different levels of WU.
- TYM Fund has offices in 17 districts of 9 provinces. The Belgium-Vietnamese Credit Project operates in 79 districts of 17 provinces.
- Membership of these units is mainly very small and small. Smallest membership is 8 members and the biggest membership is 29,260 (TYM Fund). The number of units with membership of 5,000 members and over is 15, The number of units with membership from 1,000 to 5,000 is 65. Up to 101 units have membership of less than 100.
- Total number of members at the time of the study 380,625 with loan outstanding of 647,697,000,000 VND, accumulated savings balance of 17,623,200,000VND.
- In general, except few large institutions, the microfinance sector in Vietnam mainly includes small and fragmented institutions.

The above statistics does not include some organizations such as CEP, program of CSOD, clubs of CRD program etc., that are not under the umbrella of the Vietnam WU. If these organizations are included, there are about 500,000 poor and poorest households that are benefiting from microfinance. This figure is quite modest when comparing with nearly 6 million poor households that are beneficiaries of VBSP. *“However, these organizations are targeting more at the poor in rural and remote areas in Vietnam where the formal financial institutions are unable or not ready to reach out”⁽¹⁷⁾. On the other hand, these organizations often rely on a given amount of international donor’s funds to expand their operations and so far they have not had the legal status to get access to commercial funding sources.”⁽¹⁸⁾*

Microfinance programs in Vietnam often apply partly one of the following 3 approaches:

- **Grameen Bank.** Most of microfinance programs have applied the Grameen Bank I model which uses the 5 member group lending and cross-guarantee/cross-checking mechanism. This model has been used by many projects because it is appropriate, simple but quite strict.
- **Village banking.** This model was developed by the Foundation for International Community Assistance (FINCA) in middle of the 1980s. According to this model, customers form group of minimum size of 15-20 members, loan amounts are divided equally among members and each member possesses a “share” of the bank. This model did not have long existence in Vietnam.
- **Solidarity group.** This model has been developed by Accion International in Latin America. This model is often applied to programs with low level of development.

(17). Main target clientele of MFIs includes: (a) poor households; (b) ethnic minority people; and (c) households living in remote and under-developed areas.

(18). According to Decree No.28, licensed MFIs can receive trust funds from institutional and individual investors



Products provided:

Almost all microfinance programs have 2 key financial products, namely savings and credit. MFIs often apply the method of “saving first, lending later” or “saving through”⁽¹⁹⁾, few apply the method “credit first, saving later”. It is usually the case that, after a period of saving from 1 week to 3 months, the customer is eligible for borrowing the loan whose size is appropriate to his/her repayment capacity. Short-term credit products account for a large proportion. Loan size is from 500,000 VND (USD30) to 30 million VND (USD1,600). The announced interest rate is from 0.9% to 2% per month. Loan term is from 6 to 12 months while the term of medium-term loan is 24 months. The repayment can be made weekly, or every fortnight or monthly. Recently, some MFIs such as TYM and M7 have implemented the micro-insurance products – a social insurance for low-income people. The service delivery system is based on the network of MFIs. This combination increases the value of both microfinance and microinsurance products and enhances the status of MFIs. On one hand, customers are protected against possible risks and therefore, they become loyal to the MFI; on the other hand, the loan portfolio of the MFI is safeguarded when the borrower dies before completing his/her debt repayment.

Although microfinance practitioners have made considerable efforts, there are still many challenges and constraints to microfinance sector mainly because “...Viet Nam has not had a comprehensive and consistent strategy for the microfinance sector.... Therefore, the microfinance sector is still fragmented, under-regulated and inefficient in both savings and credit services...”⁽²⁰⁾.

After the Decree 28 and Decree 165 came into effect, microfinance sector has demonstrated positive signals of growth and achieved significant results in terms of improved human resource, organizational development, expanded outreach with higher quality and more diverse products.

V. ACHIEVEMENTS OF MICROFINANCE SECTOR

Performance of MFIs is often assessed in the 2 following dimensions: (1) Effectiveness of MFIs in improving access to financial services for the poor; and (2) socio-economic impact of microfinance on customers, households and communities.

1 Improving the provision of financial services for the poor

1.1 The formation and the development of a service delivery system for households that are facing economic challenges.

Over nearly 20 years of operation, semi-formal MFIs have created a channel for providing financial services based on trust and institutionalized in the form of policy and procedure system which is appropriate to the needs and capacity of poor and low-income households, especially women. Its fundamental principles are based on a coherent combination of Grameen Bank methodology and Vietnamese culture. This system is spreading from the mountainous North West (Sơn La and Điện Biên province) to the Southern Central Coast (Ninh Thuận) and the South East delta (Tiền Giang, Cần Thơ, Bến Tre...). It is especially concentrated in mountainous, difficult, under-developed and ethnic minority areas. In North West: 72% of customers of the Mai Sơn Fund for Assisting the development of mountainous women (Sơn La province) are ethnic minority women while in Điện Biên district (Điện Biên province) and Ninh Phuoc district (Ninh Thuan province), this proportion is 85.6%⁽²¹⁾, and 18% (Chăm ethnic group), respectively. On average, the proportion of poor households is about 70% of the total customers of MFIs.

TYM Fund has a network of 33 branches in 8 Northern provinces⁽²²⁾ which is serving more than 36,000 rural poor and low-income women. CEP has 22 branches which are almost covering all districts of HCMC and even expanding into neighbouring provinces. With 276 staff, CEP is providing high quality services to nearly 119,000 members⁽²³⁾. The M7 Microfinance network including 7 microfinance service providers is providing microfinance services to nearly 35,000 members in 60 communes of 8 districts/towns or 5

(19). Savings and Credit at the same time

(20). WB Report, September 2006

(21). Data as of September 2009 was provided by M7

(22). Hà Nội, Phúc Yên, Thái Nguyên, Bắc Ninh, Hương Yên, Nam Định, Thanh Hóa, Nghệ An

(23). Source: Data as of 30 June 2009 was provided by CEP



poor Northern provinces and Central coastal provinces. The distinct feature of M7 is the targeted group that M7 is serving, namely women and ethnic minority groups in mountainous and poor areas, where there is an absence or limited presence of formal financial system.

Despite different organizational structures, MFIs have the following common features in their credit policies:

- a) Group guarantee as a substitute for collateral in order to mitigate credit risk;
- b) Once short-term loans are repaid successfully, the loan size of the next round will increase;
- c) Savings required as a precondition for credit;
- d) Loan repayment is structured in equal installments, including both principal and interest;
- e) Lending interest rate is set at the level that is high enough to cover operating expenses;
- f) Strict and disciplinary control system is in place to monitor the use of loan and ensure the timely and proper repayment;
- g) Regular education is conducted through cluster's/group's meetings in order to build and develop both capacity and integrity.

Although most of MFIs are semi-formal, their service delivery is conducted through a formal organizational structure in combination with a clear-cut credit policy and procedure system, a good monitoring system, and an accounting system that is based on international good practice and norms and sometimes stricter than those procedures applied by commercial banks⁽²⁴⁾. CEP has received **"CGAP Financial Transparency Award"**.

It has been interestingly found that, despite the presence of 2 big rural-focused banks, namely VBARD and VBSP, many customers still opt for the services of MFIs. Results of the review of Action Aid funded microfinance program in some district level MFIs show that: the proportion of poor households having borrowed from semi-formal MFIs is higher than that of formal MFIs. A 2004 study in Thanh Hoa province⁽²⁵⁾ found that: Savings and Credit Organizations in Ba Thuoc district were providing credit service to 48.1% of poor households, as compared with 27.2% and 47% in the case of VBSP and VBARD, respectively. In disadvantaged areas such as mountainous and remote areas, MFIs tend to reach higher proportion of poor households. For example, this proportion is 52% in Mai Sơn district, Sơn La province and 47% in Đông Triều district, Quảng Ninh province, as compared with the average of 42% and 26% in the case of VBARD and VBSP, respectively in the same 2 districts.

However, there are also other views on the role of microfinance. According to these, microfinance only has instant effectiveness in terms of poverty reduction and the formal financial system that has been providing large funding source, is more effective in assisting farmers to develop their livelihoods in a sustainable way. Such difference was highlighted by Professor, Dr. Muhammad Yunus in a meeting with donors, government officials and microfinance practitioners, held by the Central WU on the occasion of his visit to Vietnam in June 1995: "if funds of formal financial institution lent to farmers are compared with water of rivers and lakes, the microfinance institutions are compared to small canals leading water to fields and gardens of households".

The actual performance of microfinance sector is more than such comparison. MFIs are also the supporting system for banks in terms of debt collection. In many localities, borrowers of VBARD and especially VBSP fail to repay loans in full. There are communes being imposed "embargo" on for years by banks due to the high volume of bad debts there. Meanwhile, semi-formal MFIs have been "brave" to penetrate the "embargoed areas" to lend and the positive result is that the poor households have been able to repay properly⁽²⁶⁾. In light of such improved repayment performance, banks have "bent the fence" by resuming their lending.

Recently, in light of fluctuations in Vietnam's financial market caused by the international financial crisis and the policy measures, including the stimulus package, initiated by the Government, M7 has made a rapid assessment of the loan outstanding owed by members. 2,853 members of M7 in 21 communes/wards of 7 districts/towns of 5 provinces have been included in the survey sample⁽²⁷⁾.

(24). Remarks of Mrs. Nguyen Thanh Hop, former Deputy Director of Bank Dept., State Bank of Vietnam when commenting on Ninh Phước Fund

(25). Towards a sustainable microfinance sector in Vietnam, discussion paper of ILO, Lê Thị Lân and Trần Như An, 2005

(26). An Hải commune of Ninh Phước district, during 2000-2001

(27). Rapid assessment by M7 in early November 2009



The survey result shows that:

Table 2: Existing borrowing status of M7 members with regard to the local financial institutions.

No.	Organization	No. of clusters	Total Respondents	Borrowing from M7		VBSP		VBARD	
				Borrower In deb.	Loan outstanding	Borrower In deb.	Loan outstanding	Borrower In deb.	Loan outstanding
1	Mai Son	8	130	130	653,700	64	656,000	2	50,000
2	Uong Bi	11	422	231	899,560	73	708,100		
3	Dong Trieu	31	1,244	812	3,312,210	222	2,420,000	38	780,000
4	Dien Bien Phu city	12	311	268	719,500	67	700,500	17	213,000
5	Dien Bien district	9	217	172	287,308	59	535,000	21	128,000
6	Can Loc	12	262	181	846,090	153	2,095,100	77	1,326,000
7	Ninh Phuoc	11	267	267	709,069	41	362,339		
	Total	94	2,853	2061	7,427,437	679	7,477,039	155	2,497,000

The rapid assessment results show that, as of survey time, up to 72% of customers are currently having loan outstanding in which 24% and 5% of customers are borrowing from VBSP and VBARD, respectively. This indicates the fact that, in the same geographical location and for 1 customer, he/she can get access to all lending organizations in order to borrow different kinds of loans which satisfy different needs. However, further investigation is needed to verify the informal news that M7 customers have borrowed loans from banks with subsidized lending interest rate and then deposited such amount of money at M7 with higher savings interest rate.

Market structure is as follows:

Figure 3: Market share in terms of loan volume and loan portfolio to the same group of M7's customers

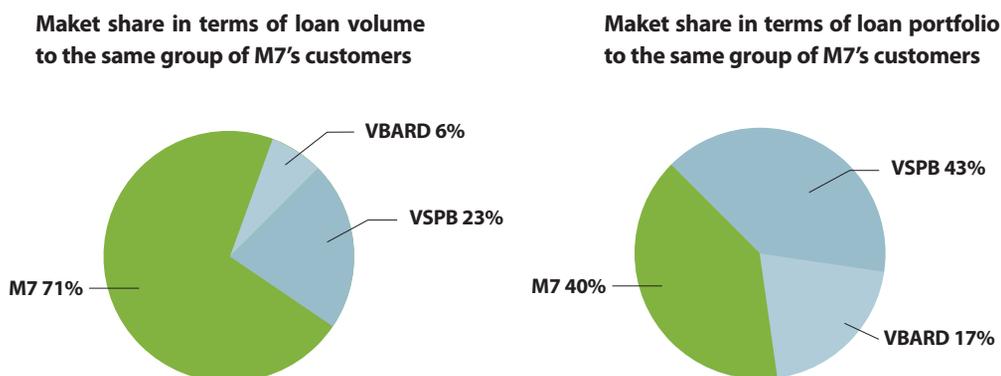
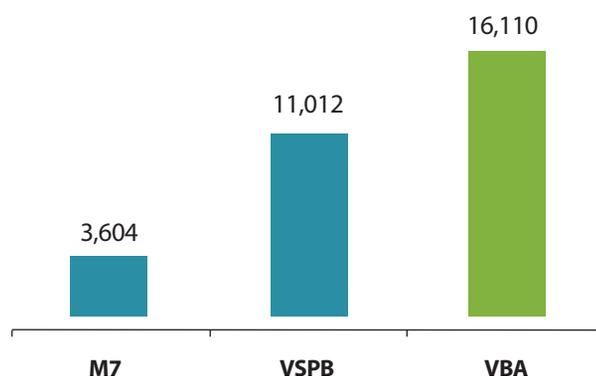


Figure 3 shows that the M7's market share in terms of loan volume is up to 71% while its market share in terms of loan portfolio is only 40%. Whereas, the market share of VBSP is 23% and 43%, respectively. This fact is understandable because the VBSP loan size is much bigger than that of M7 and because of the installment repayment policy of M7 that help reduce the outstanding balance and the accompanying risks. Those institutions that make big loans with longer term and lump sum repayment are likely to encounter bigger risks.

Figure 4: Comparison of the average loan outstanding per customer among M7 customers who are borrowing from 3 institutions at the same time

The observation of the average loan outstanding per loan indicates that M7 is extending loans whose sizes are about a third of that of VBSP and one fifth of that of VBARD. It is interesting to note that despite larger loans already borrowed from 2 banks, customers are still borrowing smaller loans from M7. Although further study is needed to explain this practice, an apparent reason is the diversity and the flexibility of the service delivery mechanism that is satisfying the increasingly diversified needs of customers.



**Average Outstanding per client of three lenders
(as Nov.09; Unit VND1000)**

The detailed data of PPC Can Loc and the microfinance program of Dien Bien district on borrowers and loan portfolio shows that, for 390 active borrowers, the loan volume of M7 accounts for 96%; the proportion of borrowers who had borrowed from 2 lenders (bank and social fund) is 38% and the proportion of borrowers who had borrowed from 3 lenders is 18%. This finding needs to be further analyzed in order to have implications for making the service delivery of respective institutions in the most effective way.

Financial management and book-keeping modality are different among MFIs. Larger MFIs have applied international and Vietnamese accounting standards. Some MFIs have used financial analysis ratios as a management tool and integrated into their reporting system (CEP, M7 Đông Triều).

Table 5: Performance of selected MFIs in Vietnam (30/6/09)

MFI	Operational Self Sufficiency (OSS)	Financial Self Sufficiency (FSS)	Return on Assets (ROA) for the first 6months of 2009	Return on Assets (ROA) for the first 6months of 2009
CEP	136%	100,4%	3,2%	10,2%
TYM	282,3%	153,5%	5,3%	16,3%
M7	140%	136%	2,1%	4,5%
Thanh Hoa fund	173%	81%	- 0,0073%	0.00%
Binh Minh	99%	85%	-0,13%	-0,26%

In general, over nearly 2 decades of substantial efforts, Vietnamese microfinance practitioners, with the collaboration of about half a million poor people and with the support of international organizations and local authorities/mass organizations at different levels, have established and developed a microfinance service delivery system with up-to-date technology. The first ever and newly established legal framework will be improved gradually, enabling the more rapid and more steady development of the microfinance sector and helping the sector to integrate into the formal financial system and as a result, more people from all walks of life will be served with better and more diversified products.

1.2 Provision of flexible microfinance services that satisfy diverse needs of low income and poor households.

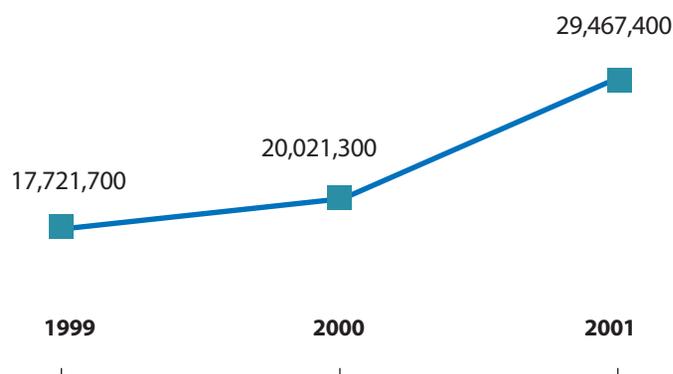
The flexibility of microfinance technology stems from the human notion of equal opportunity for everyone. Savings products are aimed at helping the poor to accumulate assets before obtaining credit.

- Savings service enables the poor to build own assets and also creates funding source for MFIs.

Like other walks of life in the society, the poor really want to save and even more than anyone else, they need savings in order to cope with and overcome poverty and uncertainty in their lives. Unfortunately, formal financial institutions have ignored this market segment due to their profit oriented purpose. Whereas, semi-formal MFIs strongly believe that the poor can save if being provided with appropriate savings services. Savings products of semi-formal MFIs are designed in such a way to enable the poor to build their own assets of bigger amount of money on the basis of accumulated small savings which in turn helps them to expand their investment or to cope with risks. There is no constraint on the savings amount to be deposited, even such small amounts of 500VND, 1,000VND; however, members are required to deposit regular savings at cluster/group's meetings in order to raise the awareness, create the habit and train the will of members. Savings interest rates are set at appropriate levels in order to provide incentive to depositors and it is often the case that, after a certain period of depositing savings, depositors are eligible for borrowing an amount that is much greater than their savings balance. In 1990s, the Savings and Credit program carried out by Action Aid in Son La province made an amazing achievement that was hardly to believe. At that time, 247 H'mong women who were members of Action Aid's savings and credit program in Ta Hoc commune, Mai Son district demonstrated that they were able to do what other ethnic groups in other regions had done.

Figure 6: H'mong people's savings performance of the first 3 years of the program

Savings balance of Ethnic minority H'mong in Tahoc commune in Mai Son (unit VND)



In HoChiMinh city where the savings habit of the large population hardly exists, 130,000 poor members of CEP have built up a savings amount of 120 billion VND after nearly 2 decades of practicing saving. Savings services have indirectly improved the capability of human resource because, in order to have money to save, the poor have to make careful budget calculation and their planning and budgeting skills have therefore been strengthened. For the lenders, members' savings plays the role of a loan guarantee and a source of funds for expanded lending which helps improve the revenue of MFIs.



Over 10 years of operation, M7 has relied mainly on the increasing savings of members to expand lending to its members.

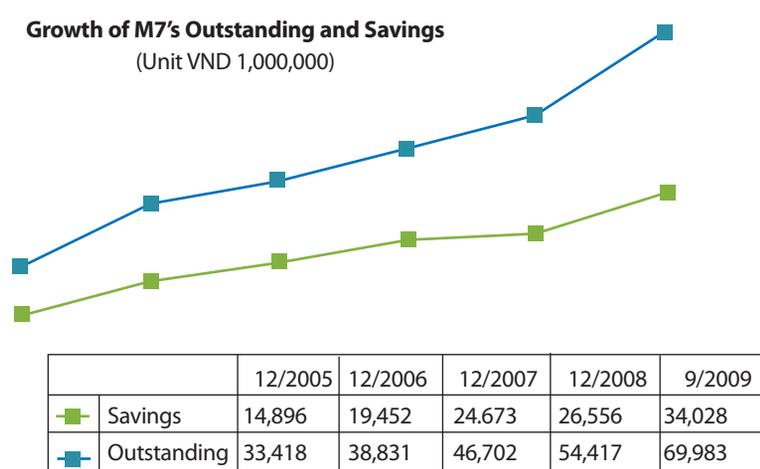
- Provision of diversified credit products which provide the poor with resource for conducting business activities and improving their lives.

Credit products offered by semi-formal MFIs are often more appropriate to the needs and the repayment capacity of the poor; their transaction offices are also close to the community and the accessibility to credit services is easier, more convenient and less costly for borrowers.

Over the last 2 decades, the microfinance network of more than 300 programs/project implemented by WU at different levels has expanded throughout the country, passing through disadvantaged areas out of reach of the formal financial sector, and reaching population group ignored by the formal financial sector. This network has a trust in poor people and provides them with non-collateralised loans so that the poor people are able to conduct income-generating activities and improve their lives. Credit products of semi-formal MFIs are very diversified in terms of loan size, loan term, loan use and repayment method. In addition to short-term and medium-term loans, MFIs provide supplementary loans when customers need to expand their projects or to retain their products when market prices fluctuate downwards. Customers also can use supplementary loans for consumption or education of their children. The repayment modality with flexible installments (weekly, fortnight, monthly, quarterly) is quite compatible with the seasonal nature of agriculture business.

Although the source of funds for extending loans has been constrained for years due to various reasons, the most important thing is the persistence of MFIs in working with the poor and their continued provision of increasing loans to the poor customers until the latter escape from poverty and become better off. After the issuance of Decree No.28 and Decree No.165- 2007/ND-CP on the organization and operation of MFIs, the savings mobilization and credit expansion performance of MFIs has experienced substantial growth. Social investors and donors have actively extended preferential loans to organizations that are potentially licensed MFIs. In 2009, M7 received a preferential loan from an external donor and thanks to this, the lending performance has been improved considerably.

Figure 7: Savings and credit performance of M7



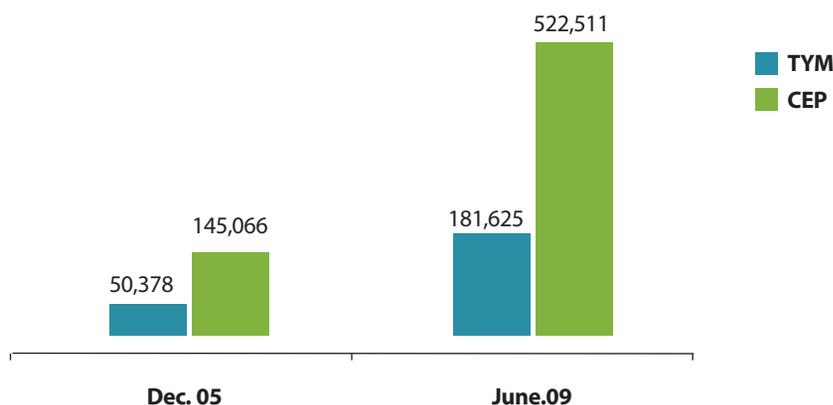
Savings mobilization of M7 improved slowly because the member organizations are not allowed to mobilize savings from the community. The limited funding source has led to constrained increase of loan portfolio. At the end of 2008 and 2009, the growth was more evident with increased external savings mobilization and expanded loan outstanding because these organization strongly believed that they would be licensed soon.



For the two organizations, namely TYM and CEP, their growth is considered ideal thanks to their professionalism in operations, their independent legal entity status and the opportunities in accessing external funding over the last several years.

Table 8: Growth in loan outstanding balance of TYM and CEP after the issuance of Decree 28 and Decree 165

Outstanding of TYM & CEP before and after the announcement of No.28 Decree (unit VND1.000.000)



2. Socio-economic impacts

2.1 Contribution to poverty reduction, job creation, diversification of income-generation activities and improvement of living standards

Results of evaluation of microfinance programs in both Vietnam and other countries in the world show that, despite various degrees of management and technical skills in different microfinance programs, there is a common assessment that, microfinance has important socio-economic impacts. The Bangladesh Rural Advancement Committee indicates that the household consumption and the assets of their customers increased 28%, and 112%, respectively. After 8 years of joining the program, 57.5% of households that were customers of Grameen Bank, escaped from poverty while only 18% of households who were not customers of Grameen Bank did so.

Similarly, impact evaluations in Vietnam of CEP, World Vision, and Microfinance program in Ky Anh district of Ha Tinh province, indicate that, after 5 years of program participation, a large number of “poorest” households became “poor households” and more middle income households became better off households. The child undernutrition rate of poor households who were program members experience larger reduction as compared with that of non-members’ households.

The consumption, purchase of new assets and house build-up/renovation have increased. Some women revealed “after washing, we even add Comfort for softer and more fragrant clothes⁽²⁸⁾”. In terms of housing, most of participating households have changed from thatch roof houses to brick houses⁽²⁹⁾. In addition, many households were able to buy household appliances such as fans, radios, TVs, beds and vehicles such as bicycles or motorbikes. Living standards of poor households have been improved and the poverty rate has been reduced, contributing to the achievement of the national poverty reduction targets.

2.2 Strengthening the participation and contribution of the poor to the national economy.

A microfinance loan can increase the effectiveness and the added value of poor households’ economic activities and therefore strengthens their participation and contribution to the national economy.

(28). Remark of a female member of a microfinance program of World Vision in Quang Nam province

(29). Based on the evaluation of impacts of SCUS microfinance program in Nông Cống district (December 2003) and 10 year performance report of TYM (2002).

Accessibility to microfinance helps the household to use labour in a more effective way, to have more employment and to expand the extent of interaction. Many female members of TYM Fund indicated that, before joining TYM, they had been mainly confined to the home village while they were then able to carry products to provincial town or the capital city for selling at a better price and thus earned more money. A microfinance loan also helps customer expand the existing production activities and create more jobs for the community. For example, many long-term customers of TYM are now owners of small enterprises and early childhood education establishments that are recruiting underemployed people in the community, including skilled labour and people from low-income households.

2.3 Improving the quality of human resource and strengthening the relationships among the community.

Thanks to strict requirements of the collateral substitute (i.e., mandatory savings and the periodic installment of loan principal and interests, the mandatory full participation in cluster's meetings and the cross-checking of loan use among members, the poor people have established the discipline and had a well-planned life. The mechanism of rotating cluster/group leader among members applied by TYM Fund has gradually built up a managerial human resource. As required by the assignment, these people had to make monthly, quarterly and annual plans; to manage the implementation of such plans and then to make annual review. The final result is the formation of an army of officers with good advocacy skill, organizational skill and convening skill who are able to orient people towards the achievement of the Fund's objectives. Within 5 years, every member in the 5-member group had to experience the position of group leader at least once. As time goes by, the relationship within the group/cluster has been strengthened. Members have joined to establish the welfare fund for common activities. In some clusters, welfare funds worth up to hundreds of millions VND which have been spent on study tours, uniforms, birthday gifts, visits to sick members. A new organizational culture has been created and strengthened from group/cluster to community, making the country-side atmosphere more lively and cozier.

2.4 Improvement of women's status

Most of customers of semi-formal MFIs are women. A microfinance loan enables them to better manage the economic affairs of their families. The loan gives the woman the perception of financial autonomy and empowers her to make decision within her family. Female customers also learn how to approach a financial institution – the first and essential step for building the customer's capacity in accessing formal financial sector's services. Thanks to periodic cluster's meetings, female customers learn business skills and useful information on health, nutrition, etc., which enable them to have a better and more effective management of their economic activities and family affairs.

2.5 Capacity building for political-social organizations.

Majority of microfinance programs have been carried out by mass organizations in which WU plays a dominant role and WU staff have been trained extensively by these programs. Such local partners have been equipped with knowledge on microfinance, on organizational development and management. A new working approach for these organizations has been formed and developed. In addition, because microfinance program's members, who are mainly women, have enjoyed the benefits brought about by the WU, they are more loyal to the WU and as a result, WU has developed further and obtained improved credibility.

3. Attracting the attention of donors and global microfinance practitioners.

Vietnamese microfinance sector has a close relationship with the global microfinance community which is evident by the participation in the regional and global microfinance network (CASHPOR, Grameen Bank Global and the global microcredit summit movement) of some big Vietnamese MFIs. As a result, Vietnamese microfinance sector has received up-to-date technical assistance from CGAP, and also been shared valuable experience in microfinance conferences, workshops and forums. After the admission of Vietnam to WTO, a number of Vietnamese MFIs has joined The MIX, an useful information channel for all donors, investors, policy-makers and MFIs themselves. A new partnership of Vietnamese microfinance practitioners and international donors/investors has been created, this is the partnership in the commercialization of microfinance in Vietnam.



VI. CONSTRAINTS & DIFFICULTIES FOR MICROFINANCE IN VIETNAM

Although Vietnamese microfinance sector has made important strides towards international best practice and been recognized for its considerable contributions as mentioned above, there are still many constraints and difficulties that undermine its potential growth and financial sustainability. These constraints and difficulties can be grouped into 2 following categories: (a) Challenges of the enabling environment including issues related to the role of the Government, the external legal and policy environment, (b) Issues related to the internal capacity of existing microfinance service providers.

1. Issues related to the enabling environment

An enabling environment for the development of microfinance needs to include the following core elements: (1) a stable macroeconomic environment and policies; (2) removal of ceiling interest rates and subsidized lending programs; (3) level playing field in the fund-raising policy and mechanism.

One of the principles of microfinance is that, the Central Government should play the role of supporting or facilitating the provision of financial services rather than the role of a direct provider of financial services⁽³⁰⁾. The involvement of the Government in funding MFIs can only be justified when there is no fund or it is difficult to access local organizations. By creating an enabling policy environment, the Government can contribute to promote the growth of a pro-poor and sustainable financial system

Generally, the macroeconomic policies and environment in Vietnam are quite stable despite adverse impacts of the recent global economic crisis. The Government had to introduce ad hoc policy measures including a package of subsidized credit for enterprises. The slow implementation led to limited number of enterprises having accessed to. This, once again, demonstrates that, it is not easy for the subsidized credit to achieve the expected results. Instead, it deepens existing challenges that microfinance sector in Vietnam is encountering:

1.1 There is a gap between the understanding of government and relevant authorities on microfinance and the international standards on microfinance.

Globally, microfinance has had a history of development throughout the 20th century to date. Microfinance has been studied in depth, practical experience and lessons learnt have been consolidated. In many countries, microfinance has become a part of the banking-finance sector. There are many well-known banks specialized in microfinance. However, in Vietnam there is still a gap in the proper understanding of microfinance. The mindset that considers microfinance as a subsidized poverty reduction tool or mass organizations' movements has been rooted for quite a long time in line ministries, policy-makers and local authorities. In addition, many projects have included microfinance component as a "spice" rather than a key activity that needs to be professionalized.

Thanks to this mind-set, the Government has channeled funds through state-owned financial institutions such as VBARD and VBSP in order to deliver subsidized loans to rural areas under the framework of the poverty reduction strategy. Since 1995, despite the transformation of VBARD into a commercial bank, VBSP is still an instrument used by the Government for extending policy loans. Despite the announcement of the removal of ceiling interest rate, the State Bank of Vietnam has regulated the base interest rate with the narrow fluctuation margin which undermines the operation of credit institutions. This is the biggest challenge to MFIs because it constrains the fund-

(30). See 11 key principles of microfinance – CGAP document



raising capacity and the expansion of lending, undermining the sustainability of MFIs and ultimately causing difficulty for the poor in accessing the funding and convenient services offered by MFIs.

1.2 The existence of VBSP with the existing operational mechanism is a direct constraint to microfinance activities.

This institutional structure might be an instrument of the Government to serve a political objective for a certain period. However, the presence of this bank coupled with the mechanism of requiring commercial banks to make compulsory funding contribution has created an unfair playing field for both MFIs and commercial banks. Especially, the subsidy of lending interest rates that comes from state budget has put the burden on other groups. Moreover, the subsidized interest rate has caused the number of “poor people” to increase when VBSP disbursed loans while the real poor people were still waiting. From the perspective of mobilizing resources, the existing lending policy of VBSP has hardly attracted the poor people to participate in the economy in a sustainable and confident way. In fact, it makes the poor more dependent and more reliant and in many cases, these over dependent people have lost economic opportunities:

“we do not want to escape from poverty; we want to lead a life as it is now because we are subsidized by the Government”⁽³¹⁾.

The policy of distributing collected interests into different portions, including commissions for network of the delivery agents from the central level to the group level has contributed to the distortion of the price of the loan and also undermined the relationship between local partners and semi-formal MFIs which has a long-standing history but might “not be as profitable as the relationship with VBSP”.

1.3 The microfinance development strategy has not been in place.

So far, there has been no comprehensive strategy/policy which specifies the vision and strategic direction of the microfinance sector in the next 10 years. As remarked by commentators, microfinance in Vietnam is still in the initial stage⁽³²⁾, which is fragmented, small in scale and spontaneous. Some MFIs that have been persistent in pursuing their mandate of serving the poor in a sustainable way, have struggled to develop and only in very few cases, they have been externally supported. The main reason is the misunderstanding on microfinance and the lack of systematic review of experience and lessons learnt from both the grass-root and international level.

1.4 Microfinance policies are still in the initial stage which are inconsistent and not coherent.

Under the pressure of reform and integration, and after many years of preparation with the technical assistance of ADB, the Government issued the Decree 28/2005/ND-CP in 2005. This was the first legal framework that paved the way for the establishment and operation of MFIs. However, this legal framework only regulated few MFIs that were operating because the legal capital was too high and the licensing requirements were too strict. Majority of smaller MFIs that had been long for the legal framework were put outside the governing scope of the Decree and even encountered the risk of being contracted or dissolved. The Decree No. 165-2007/ND-CP was issued to revise the Decree 28 even when there was no guideline for the implementation of Decree 28. Due to various reasons, until April 2008 (half year after the issuance of Decree 165), the Circular No.02 guiding the implementation of 2 Decrees was issued while the deadline for submitting application for licence was very close already. Therefore, it has created many pressures on applicant MFIs. To date, after nearly 1 year since the submission of the application, while 3 applicant MFIs, namely CEP, TYM, M7 are waiting for the

(31). Answer of a villager in MaiSon district, SonLa province when an officer of MaiSon social fund invited her to join the savings and credit program for the purpose of escaping poverty.

(32). Vietnam: Developing a Comprehensive Strategy to Expand Access [by low income and poor people] to Microfinance Services, WB, September 2008



final approval, the Government has issued an announcement that assigns SBV to develop other legal documents to revise and cancel some articles of the 2 Decrees⁽³³⁾. On one hand, these changes created the uncertainty for applicant MFIs and on the other hand, it reflects the confusion of the policy-makers when there is neither a comprehensive strategy nor a right viewpoint.

The draft revised Law on Credit institutions has put MFIs in the list of regulated institutions but has not taken into account the social mission, the distinct features of the clientele and the special mechanism of microfinance. Therefore, MFIs have been regulated under the general provisions applicable to other credit institutions. These general provisions are sources of the discouragement of the development of microfinance sector. The draft Law has a separate part with article 87 and article 88 for provisions related to MFIs but the contents are not clear enough which discourages the development of MFIs in terms of organizational structure and operational network.

1.5 Absence of fund-raising policies & mechanisms for the operation & the development of MFIs

While every year the Government set aside a large budget for subsidized lending and subsidy for VBSP, there is almost no financial support from local authorities, except HCMC authority. In addition to the support to VBSP, the Government has created favourable legal and policy environment to encourage the development of private sector's enterprises in order to promote the market-oriented economic development. One of these policies is the mechanism for foreign borrowings of enterprises (Decree No.134) but semi-formal MFIs are not considered as enterprises and therefore can not benefit from this mechanism. It can be said that, in terms of fund-raising, semi-formal MFIs are now in the situation of "being blocked". The following policies have discouraged the fund-raising capacity of semi-formal MFIs: (1) prohibition of mobilizing voluntary savings, (2) the maximum savings balance to equity ratio is less than 50% (Decree No.28 and Decree No.165) while international best practice propose the savings to assets ratio of 70% to 80%; Savings balance of Grameen Bank even exceeds loan outstanding; (3) Inability to borrow from wholesale lending for poverty reduction funded by WB, ADB; (4) Inability to receive preferential lending from the national programs that share the same targeted customers; (5) Inability to borrow foreign loans as regulated by Decree 134 (those institutions that have already borrowed to on-lend to the poor have not been given the repayment modality).

Fund-raising is the key to the survival and development of MFIs but all possible channels have been blocked. Removal of such barrier is expected to significantly benefit semi-formal MFIs.

1.6 Limitations of SBV's human resource dedicated to microfinance.

SBV is in the process of organizational restructure and personnel re-arrangement. SBV's human resource dedicated to microfinance is limited in many aspects and also changed so often, making the completion of microfinance-related procedures non-continuous and slower. This is one of the main constraints.

2. Internal issues of MFIs

The constraints and limitations of MFIs can be grouped in 2 categories: (1) internal issues of each MFI, and (2) the inter-relation/linkage among MFIs.

As mentioned above, up to 300 organizations are conducting microfinance activities with different scales and levels of development because of the starting point and the history of establishment are not the same. A portion of these organization are developing towards professional MFIs and encountering the following challenges:

(33). Announcement No. 229/TB-VPCP, dated 31/7/2009



2.1 Constraints and shortcomings of each MFI

- **The understanding on microfinance within MFIs is inadequate, slowing down the process of transformation and establishment of professional institutions.** Most of microfinance programs are originated from mass organizations. These programs have the same targeted beneficiaries of and shared the vision with mass organizations. However, there is a difference in the approach that is difficult to notice and even when having been noticed, it is difficult to accept the change due to various reasons. Mass organizations mainly use the advising/educating approach while MFIs are using approach in which the MFIs hand over the poor the authority to manage an amount of money as a tool to overcome poverty. This tool attaches some requirements on repayment modality and requires the poor to take action. In the case of mass organizations, the operational expenses of the microfinance program are mixed up with those of the governing mass organization and the same applies to income generated from microfinance activities. When being separated in terms of organizational structure, MFIs have to cover operational expenses by income generated from their operations. Besides, in the absence of appropriate legal framework for the establishment of MFIs, it is difficult to have independent MFIs and therefore it slows down the development of microfinance sector in Vietnam.
- **The organizational structure has not been defined.** Due to different history of establishment, the organizational structures of different MFIs are different. Among 3 MFIs currently applying for MFI licence, their organizational structures are very different despite the fact that all 3 organizations claim that they are Grameen Bank's replicators. TYM Fund was developed on the basis of learning from original Grameen Bank model and the Grameen Bank model applied in CARD⁽³⁴⁾ Philippines. TYM Fund's organizational structure includes 3 levels: Head office, regional offices and branch offices. However, since the administrative structure in Vietnam is different from that of Bangladesh, the actual model in Vietnam needs certain adjustment. CEP's organizational structure includes 2 levels: Head office and branches. M7 includes several organizations that join together to set up an MFI and opts for the structure that includes: Head office, branches and transaction offices. M7 has learnt from the model and branch network of VBARD and therefore its network model is similar to the model specified in the SBV's regulation on MFI's network. Those microfinance programs that have not been satisfied requirements of Decree 28/Decree 165, have chosen the legal basis prescribed by Decree 148 – 2007/ND-CP on the organization and operations of social funds and charity funds. However, this model is only a transitional step in the transformational process because there are many limitations when microfinance is the core activity of social/charity funds.
- **Lack of human resource with managerial skills.** When being interviewed through questionnaire⁽³⁵⁾, Vietnamese microfinance practitioners ranked this issue in the group of most difficult issues. The lack and the weakness of human resource for microfinance management in Vietnam are the obvious result of a process where microfinance has been misunderstood and lacked a long term strategy. In the initial stage, organizations engaged in microfinance missed and failed to take advantage of many opportunities in the region and in the world for Vietnam. While many senior and well-trained officers of older generation were moved to other assignment or no longer worked, officers of the younger generation lack basic training and therefore often work on the basis of on-the-job experience. At present, it is quite difficult to find out adequate quantity of officers who are capable of managing professional MFIs. Although there are some highly qualified scholars who are involved in microfinance studies, they are mainly microfinance theorists and might not be relevant as MFI managers.
- **Lack of facilities for microfinance training.** The management information system and the application of software for management are still very primitive. The basic training material and

(34). Center for Agriculture and Rural Development (Philippines)

(35). Interviews conducted in April 2005 under a study funded by an ILO project

(36). Remarks of Prof., Dr. Nguyen Kim Anh, Deputy Director of Banking Academy at the Workshop on final review of Ford Foundation's project and the introduction of the Manual for supervising M7's MFIs, June 2008

(37). Written comments of Mr. Trương Ngọc Anh, Deputy Director of Bank Department of SBV in 2008 on the Manual for supervising M7's MFIs,



specialized training material on microfinance that are Vietnam-specific and standardized have not been available although there are many good training materials of CGAP and successful MFIs in the world and in Vietnam. Most of organizations involved in microfinance have prepared their own training programs. Recently, there have been some institutions involved in microfinance training, such as the Microfinance and Development Center (M&D); Community Finance Resource Center (CFRC), Microfinance and Community Development Institute (MACDI)..., but their activities are still in the infant stage. Capacity building for MFIs conducted by CFRC includes the development of training materials and technical manual on the basis of international practice combined with experience in Vietnam, and the provision of training courses for interested institutions. Although CFRC has been commended as “the pioneer in standardizing documents on microfinance”⁽³⁶⁾ and the Manual for supervising M7’s MFIs has been regarded as “a technical manual”⁽³⁷⁾, the scope of operations of CFRC is mainly dedicated to M7. Out of 31 training courses on microfinance and microinsurance offered by CFRC over the last 2 years, only 7 training courses are for organizations that are not member organizations of M7.

● **Critical lack of funds**

Fund is the key input for microfinance activity but, as analyzed above, there is an absence of supporting funds for semi-formal MFIs coupled with the regulation that blocks the fund-raising, semi-formal MFIs do not have enough inputs and thus are unable to expand their operations.

2.2 Constraints and limitations of the inter-relation/linkage among MFIs

● Lack of a connection among semi-formal MFIs. The number of strong institution with qualified human resource is inadequate so that it is difficult to establish a microfinance network that is able to represent the Vietnamese microfinance sector. In history of Vietnamese microfinance sector, a number of networking initiatives has been set up (Microfinance Forum, Save Children UK – 1993; Microfinance Resource Centre – National Economic University– 1999; Save Children US – 2002, MFWG – 2005) to connect organizations involved in microfinance, to promote information-sharing and the development of microfinance sector. However, due to various reasons such as lack of leadership and vision, fund-raising mechanism and capacity, the readiness of member organizations, the operation of these networking institutions have only survived in the initial stage. This is the result of a lack of vision, the lack of attention and investment of microfinance practitioners, donors and government agencies.

VII. RECOMMENDATIONS

1. To develop a long-term microfinance development strategy

In order to develop the long-term development strategy of the microfinance sector, the Government issued the Decision No.1450/QĐ-TTg dated 16/9/2009 on the establishment of the Working Group on Microfinance. This reflects the view of the Government in determining to promote the development of microfinance sector. However, in order to implement the strategy, it is required to have specific plans, clear roadmap with planned milestones and planned objectives for each stage and the participation of a full-time and professional human resource that is knowledgeable of the socio-economic development strategy, banking and finance and microfinance.

1.1 To reach consensus on key directions of the Vietnamese microfinance sector

In order to lay the ground for the development of a high quality and feasible strategy, the first thing is to reach consensus on the following key directions of the Vietnamese microfinance sector: (1) Define clearly the role and goal of poverty reduction in the national socio-economic development strategy; (2) MFIs have the mission of providing microfinance services to achieve the poverty reduction goal; (3) MFIs are a type of social enterprises but require financial sustainability; (4)



Targeted clientele/focused operation of MFIs is low income and poor people, and other specific groups living in poor and disadvantaged areas; (5) MFIs can register their operations in the form of either not-for-profit organization or for-profit organization and will be subject to respective regulations; no tax imposed on not-for-profit organizations while different tax regimes applied to for-profit organizations; (6) Application of negotiated interest rates for this sector because of high cost of managing a large volume of small loans and the social mission of MFIs; (7) The Government's support should focus on the creation of an enabling environment for the development of MFIs rather than the direct intervention; (8) To have policies on support to fundraising and on encouragement of organizations that provide technical assistance to MFIs in terms of capacity building, study and development of management standards and norms, etc. (9) To encourage and to support MFIs to establish their networks and gradually move towards the establishment of the Association of MFIs.

1.2 Supplement members of the Microfinance Working Group

It is necessary to supplement new members in the composition of the Microfinance Working Group. As specified in Decision No. 1450 QĐ-TTg , up to 14 leaders of related line ministries but there is no representation of the Labour Confederation, and especially there is an absence of knowledgeable microfinance specialists and experienced microfinance practitioners that have nearly experience in developing Vietnamese microfinance sector, namely CEP in urban areas, TYM in rural areas and M7 in mountainous areas. These organizations need to represent in the Microfinance Working Group and also in the Secretariat of the Group. Their absence is likely to affect the feasibility of the strategy and related policies to promote the development of microfinance sector.

1.3 To conduct a survey or take comprehensive stock of the current situation of MFIs in Vietnam

The first task that the Microfinance Working Group should do is to conduct a comprehensive survey of MFIs in Vietnam which includes both institutional and financial information such as: (1) Number and membership scale of MFIs; (2) Organizational structure and Personnel in charge of management; (3) Policies and procedures; (4) Financial information: savings balance, outstanding loan balance, assets and sources of funds. Such information is very useful for the analysis, the assessment and the development of strategy.

1.4 Evaluation of the current subsidized credit policies

Experience in the world and in Vietnam over the years has shown that subsidized credit is not a good policy measure for the sustainable socio-economic development and poverty reduction because the financing for subsidized credit which comes from tax-payers is not abundant. The inefficient and inappropriate use of this financing source is likely to worry the public. On one hand, the subsidized credit can only reach a portion of poor people who are eligible for or just lucky; leaving behind a large group of unqualified low-income people which are also not targeted by VBARD. On the other hand, the subsidized credit is likely to nurture the proliferation of corruption and the inequality within the community that undermines the community solidarity. In addition, it induces misleading expectations and increases the dependency of the poor people which discourage their willingness to escape from poverty. It is often the case that, when VBSP disburses preferential loans, other commercial banks are capable of mobilizing a large amount of money from those borrowers of VBSP who do not know how to make use of the preferential loans. Another consequence of subsidized credit is the unhealthy competition in the financial market that make it more difficult for the poor to get access to loans. Therefore, it is necessary to revisit this approach by shifting to the investment in education and health care facilities for the poor areas and supporting the capacity building for MFIs.



1.5 Development of microfinance development strategy for the next 10 year period

2. Things need to do immediately

2.1 To strengthen SBV's human resource in charge of regulating MFIs and guiding the implementation of Decree 28/Decree 165. In parallel with the development of the microfinance development strategy, it is required to add more high quality human resource for the unit in charge of regulating the operations of MFIs. To organize training courses on management of MFIs and even to invite international specialists to Vietnam to support. To accelerate the review of application documents and the licensing process for existing applicant MFIs also helps to obtain hands-on experience for policy-making.

2.2 To allow MFIs and organizations that provide technical assistance to MFIs to borrow from foreign lenders and to be responsible for the foreign debt service. This is a very important and urgent issue because, if MFIs lack funds, their customers are likely to lose trust and leave the institution which undermines the existence of MFIs.

2.3 To allow MFIs to apply the negotiated interest rate policy. An evident fact is that operational expenses of MFIs are quite high so that MFIs afford to manage small loans, to empower the poor people, to help the poor people build up and protect their assets, and to become sustainable and to expand the geographical outreach. Moreover, the poor people accept such expenses because they are quite pleased with the service.

2.4 Support existing semi-formal MFIs to transform and to establish licensed MFIs. In the condition of limited resources and limited experience, the support needs to be very focused on some key areas such as the consensus on the related policies, procedures, processes. The experience and the resource of big MFIs and qualified technical assistance providers in Vietnam need to be mobilized in a most effective way.

2.5 Support the development of infrastructure for the microfinance sector. The infrastructure implies the management information system, the policy of planning and assigning land for building offices, equipments and facilities of MFIs and technical assistance providers.

2.6 To set the corporate income tax at zero level for MFIs and apply this tax policy until the completion of the comprehensive strategy and policies.



ANNEX I

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ANNEX 2

KEY PRINCIPLES OF MICROFINANCE COMPILED BY CGAP

I. Introduction about CGAP

CGAP is a consortium of 28 public and private development organizations working together to expand the financial service outreach to the poor. These principles have been developed and recognized by CGAP and 28 member organizations and more than that, these principles have been recognized by the summit of leaders of 8 G8 countries on 10 June 2004.

II. Key principles

1. *The poor need a variety of financial services, not just loans.*

Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.

2. *Microfinance is a powerful instrument against poverty.*

Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

3. *Microfinance means building financial systems that serve the poor.*

Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.

4. *Financial sustainability is necessary to reach significant numbers of poor people.*

Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operation of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unbanked poor.

5. *Microfinance is about building permanent local financial institutions.*

Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments-including government-financed development banks-will gradually diminish as local financial institutions and private capital markets mature.

6. *Microcredit is not always the answer.* Microcredit is not appropriate for everyone or every situation. The destitute and hungry who have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small

grants, infrastructure improvements, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.

7. *Interest rate ceilings can damage poor people's access to financial services.*

It costs much more to make many small loans than a few large loans. Unless microlenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. At the same time, microlenders should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be.

8. *The government's role is as an enabler, not as a direct provider of financial services.*

National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.

9. *Donor subsidies should complement, not compete with private sector capital.*

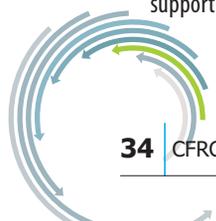
Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc.), and support experimental services and products. In some cases, longer-term donor subsidies may be required to reach sparsely populated and otherwise difficult-to-reach populations. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.

10. *The lack of institutional and human capacity is the key constraint.*

Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.

11. *The importance of financial and outreach transparency.*

Accurate, standardized, and comparable information on the financial and social performance of financial institutions providing services to the poor is imperative. Bank supervisors and regulators, donors, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.



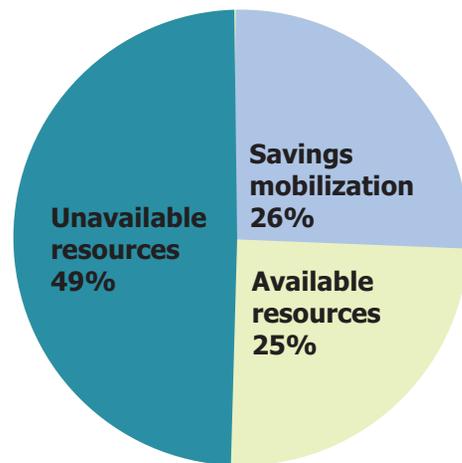
LOAN REQUIREMENT & CAPACITY TO COVER

DONG TRIEU & UONG BI - M7 MICROFINANCE NETWORK

DONG TRIEU BRANCH

Savings mobilization	26%
Available resources	25%
Unavailable resources	49%

Loan Requirement and Capacity to Cover



UONG BI BRANCH

Savings mobilization	25%
Available resources	50%
Unavailable resources	25%

Loan Requirement and Capacity to Cover

