

**Towards a Viable  
Microfinance Sector in Viet Nam:  
Issues and Challenges**

**Le Lan, Nhu-An Tran**

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## FOREWORD

This discussion paper has been written in the context of a project on the "Extension of microfinance and micro insurance to informal women workers" implemented, since 2003, by the ILO in collaboration with MoLISA and several microfinance organizations and funded by the Government of France.

The discussion paper was motivated by two goals. First, as 2005 is the United Nations International Year of Microcredit, the ILO Office in Viet Nam wished mark the occasion by calling attention to the critical contribution of that microfinance can make to the objectives of Vietnam's Comprehensive Poverty Reduction and Growth Strategy (CPRGS) and its Socio-Economic Development Plan; highlight the challenges facing the sector; and make recommendations on the expansion of the sector in the next five years.

Second, on 9 March 2005, the Government of Viet Nam enacted Decree 28 on the Organization and Operation of Microfinance Institutions. This decree creates a legal framework for microfinance activities and opens a window for the further development of this sector. However, this Decree also poses many new challenges for stakeholders. On the one hand, the degree of familiarity with microfinance varies greatly among policymakers and regulatory and supervisory entities (including the State Bank of Viet Nam), a situation which could affect the smooth implementation of the Decree. On the other hand, most microfinance organizations lack the technical skills and access to sufficient funding necessary for their transformation into legalized financial institutions and for the overall professionalization and expansion of the sector.

This discussion paper does not present an exhaustive analysis of the microfinance sector as a whole but rather focuses on the microfinance organizations that have evolved in the semi-formal sector as they are directly concerned with Decree 28. The paper, therefore, presents the main achievements of this semi-formal microfinance sector in Viet Nam to date and the challenges it will face over the next five years. It also makes a series of recommendations to overcome these challenges, the majority of which concern the new legal and regulatory environment, access to capital, and capacity building issues. We feel that these recommendations, which are addressed to policymakers, the State Bank of Viet Nam, microfinance practitioners and donors, could make a useful contribution to enabling the development of a strong and sustainable microfinance sector that actively contributes to poverty reduction in Viet Nam.

The ILO Office in Viet Nam will use the recommendations of this discussion paper to develop future activities with its microfinance partners in Viet Nam and to support the expansion of a professional sector that adheres to international best practices. It will also incorporate the recommendations of this discussion paper into its own Decent Work Country Framework.

The ILO Office in Viet Nam thanks Ms Le Lan and Ms Nhu An Tran for their careful review of microfinance sector in Viet Nam and for their insights derived from international experiences.

We also thank microfinance practitioners and policymakers who participated in the focus group discussions and interviews. Special thanks due to Ms Nguyen Thi Hoang Van (CEP), Ms Nguyen Hong Hanh (Save the Children US), Mr. William Smith and the ILO Social Finance Program's team in Geneva and Bangkok for their precious comments on the first drafts.

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## LIST OF ACRONYMS AND ABBREVIATIONS

ACLEDA	Association of Cambodia Local Economic Development Agency
ADB	Asian Development Bank
ADRA	Adventist Development and Relief Agency
CARD	Center for Agriculture and Rural Development
CEP	Capital Aid Fund for Employment of the Poor
CGAP	Consultative Group to Assist the Poorest
CIDSE	Coopération Internationale pour le Développement et la Solidarité
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
DFID	Department for International Development
FGD	Focus Group Discussion
FINCA	Foundation for International Community Assistance
GoVN	Government of Viet Nam
GSO	General Statistics Office
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IO	International Organization
INGO	International Non-Governmental Organization
MFI	Microfinance Institution
MFO	Microfinance Organization
MFWG	Microfinance Working Group
MIS	Management Information System
MOF	Ministry of Finance
MOLISA	Ministry of Labour, Invalids, and Social Affairs
NBFI	Non Banking Financial Institutions
NGO	Non-Governmental Organization
ODA	Official Development Assistance
PCF	People's Credit Fund
ROA	Return on Assets
ROSCAs	Rotating Savings and Credit Associations
SBV	State Bank of Viet Nam
SCO	Savings and Credit Organization
SPO	Socio-political Organization
SC/US	Save the Children/US
SNV	Netherlands Development Organization
SOCB	State-Owned Commercial Bank
TYM	Tao Yeu May/Compassionate Fund
USD	United States Dollar
VBARD	Viet Nam Bank for Agriculture and Rural Development
VBCP	Viet Nam-Belgium Credit Project
VBP	Viet Nam Bank for the Poor
VBSP	Viet Nam Bank for Social Policies
VND	Vietnamese Dong
VPSC	Viet Nam Postal Savings Service Company
VPT	Viet Nam Post and Telecom
VWU	Viet Nam Women's Union
WSG	Women's Savings Group
WVI	World Vision International

# EXECUTIVE SUMMARY

## I. Introduction

In Viet Nam, microfinance has made an important contribution to meet the objectives of the country's Comprehensive Poverty Reduction and Growth Strategy (CPRGS). On March 9, 2005, the Government of Viet Nam (GoVN) enacted Decree 28, Decree on the Organization and Operation of Microfinance Institutions, in order to create a legal framework for this fast-growing activity.

Nevertheless, the level of awareness and understanding about microfinance varies greatly among policymakers and regulatory and supervisory entities. Moreover, microfinance organizations (MFOs) lack the technical skills necessary for the professionalization of the sector, and have limited capacity to access sufficient funding to continue their operations.

The International Labour Organization (ILO) has commissioned this discussion paper on microfinance in Viet Nam in order to increase stakeholders' knowledge about the sector and to raise the challenges facing the sector in the next five years. The paper aims to provide recommendations regarding the legal and regulatory environment, access to capital, and capacity building issues in an effort to overcome these challenges and enable the transformation of microfinance into a professional and sustainable industry that adheres to international best practices.

## II. Suppliers of Microfinance in Viet Nam

In Viet Nam, microfinance providers can be grouped into the following three main categories: formal, semi-formal and informal.

Formal	Semi-Formal	Informal
<ul style="list-style-type: none"> <li>- Vietnam Bank for Agriculture and Rural Development (VBARD)</li> <li>- Vietnam Bank for Social Policies (VBSP)</li> <li>- Vietnam Postal Savings Service Company (VPSC)</li> </ul>	<ul style="list-style-type: none"> <li>- 57 international NGOs (Save the children/US, World Vision International, etc.)</li> <li>- 4 government-recognized MFOs:               <ul style="list-style-type: none"> <li>• <i>Tao Yeu May</i>/Compassionate Fund (TYM)</li> <li>• Capital Aid Fund for Employment of the Poor (CEP)</li> <li>• Pro-Poor Center (PPC)</li> <li>• Uong Bi Promotion of Women Development Fund</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- <i>Ho/Hui</i> (a popular form of rotating savings and credit associations (ROSCA))</li> <li>- Relatives, friends, neighbours</li> <li>- Moneylenders</li> </ul>

At the end of 2004, microfinance organizations (MFOs) of the semi-formal sector operate in 36 provinces (57%), 132 districts (23%), and 2,900 communes (27%) of the country, reaching a total of 351,298 clients. The level of outreach attained by MFOs is insignificant when compared to the 2.5 million borrowers being served by the VBSP and VBARD. However, MFOs tend to serve the more remote rural areas of Viet Nam where the formal sector does not

go. Secondly, these organizations usually rely on a limited pool of international donor funding in order to expand their operations since they have not been allowed legally to access commercial funding. Thirdly, in localities where MFOs compete directly with VBSP and VBARD, studies show that MFOs tend to reach a larger number of poor households.

### **III. Distinguishing Characteristics of Microfinance in Viet Nam**

***Involvement of socio-political organizations in microfinance.*** In Viet Nam, microfinance is implemented through the existing apparatus of the Communist Party. On the positive side, the wide-reaching network of the Viet Nam Women Union (VWU) and other socio-political organizations (SPOs) made it possible to reach poor clients in rural areas more effectively than in other countries. On the other hand, the close affiliation meant that microfinance activities were often seen as government-supported social welfare programs rather than economic development and business oriented local institutions. Apart from that, most microfinance programs could not be implemented independently from the overall organizational structure and operational policy of the SPO.

***Rural vs Urban-based Microfinance.*** The majority of clients served by Vietnamese MFOs are rural-based. This is unlike other countries with an active microfinance sector, where the majority of organizations are located in urban centers.

***State-supported Policy Lending Bank.*** The microfinance market in Viet Nam includes the existence of a formal policy lending bank, VBSP, which effectively acts as a non-profit bank that offers a full range of financial products and services at subsidized rates. With this vast capital resource base, the VBSP is positioned to take a dominant share of the microfinance market. However, the preferential lending rate used by the VBSP has the potential to cause two unhealthy effects: (a) crowd out current MFOs from the market and discourage commercial banks and new MFOs to enter the market; and (b) reinforce the subsidy-dependent attitude of poor households.

### **IV. Achievements and Impact of Microfinance in Viet Nam**

The semi-formal microfinance sector in Viet Nam has increased the provision of financial services to the poor by:

- ***Creating an alternative financial services network for the poor.*** MFOs usually target localities that are underdeveloped—i.e. lacking arable land, infrastructure and roads, vulnerable to floods and natural disasters, etc—and the primary client segment tends to be women.
- ***Meeting the financial services needs of the poor through a client-centered approach.*** Loan products offered by MFOs are more appropriate to the poor's needs and capacity to repay, and MFOs are located closer to the community and can provide easier and more convenient access to credit. Besides short-term working capital loans, MFOs also provide supplementary/emergency loans, seasonal loans, as well as medium to long-term loans for larger size investments.

Microfinance has also made a notable contribution to socio-economic development through the:

- Diversification of poor households' income source and reduction of their economic vulnerability and risk;
- Contribution in attaining the national objective of hunger eradication and poverty alleviation;
- Increased participation and contribution of poor people to country's economic production;
- Empowerment of women by raising their role and status within their own household as well as the community;
- Capacity building for socio-political organizations like the VWU.

## **V. Challenges Facing the Microfinance Sector in Viet Nam**

Several barriers and constraints remain that are hampering the Vietnamese microfinance sector's ability to reach its full outreach potential and achieve financial viability.

*Enabling environment for microfinance.* Important elements of a supportive policy environment for microfinance include a stable macroeconomic policy environment, the absence of interest rate ceilings, and the elimination of subsidized loan programs.

In Viet Nam, there exist several legal and regulatory issues:

- VBSP remains the government's vehicle for policy lending, which has resulted in an uneven playing field. While the government has removed the interest rate ceiling on loans, the fact that it continues to support the use of subsidized loans through VBSP has hampered the ability of commercially-oriented financial institutions, including banks, to compete effectively.
- The continued disbursement of preferential lending is further reinforcing the subsidy-dependent attitude of poor borrowers, i.e. the poor should not have to and cannot afford to pay market rate for credit.
- Decree 28 on the organization and operation of microfinance institutions will encourage the formalization and growth of the sector but contains no provisions to correct the distortionary effects of subsidized lending.
- Implementation of Decree 28 will pose many challenges for provincial authorities, the State Bank of Viet Nam (SBV), as well as MFOs. The related implementing circulars have not yet been published. Concerns raised by MFOs regarding restriction on the range of products they can offer, on taxation, and ownership of licensed microfinance institutions (MFIs) remain unresolved and will need to be addressed in the circulars.
- There is no comprehensive strategy or policy that sets out the vision and strategic direction for the microfinance sector in the next ten years. Since microfinance is not viewed as part of the financial sector, it was not included as a component in the country's financial sector development strategy. Moreover, the lack of networking among current microfinance providers meant that there was no unified voice to promote and advocate for the sector as a whole.



***Institution Building.*** Among the building blocks of a sustainable MFI are: (a) clear governance and management structure; (b) qualified and motivated staff; (c) efficient systems and procedures; and (d) sound and transparent financial management. The main challenges for Vietnamese MFOs in the next five years will lie in the following areas.

- Human resources is considered to be one of the biggest constraints faced by MFOs in Viet Nam. Only a few microfinance organizations have a standardized training program for incoming staff. There is a great need for regular, continued formal technical training of staff and management.
- Many MFOs have difficulty hiring and retaining staff, most often losing their qualified personnel to other international organizations and commercial banks that pay more attractive salaries. At the managerial level, the pool of qualified candidates is quite small and with the passing of Decree 28, the competition to hire a professional manager is expected to be fierce.
- Most MFOs lack a good information system and basic policies and procedures to monitor their activities. Policies and procedures to control and manage arrears are not in place and not applied uniformly throughout the sector. There is a noticeable lack of information on the savings being managed and on-lent by current MFOs, as well as liquidity management skills and investment policy for these public deposits.
- The majority of microfinance programs do not report on their financial situation. Even those that succeed in publishing financial statements may not report on hidden subsidies related to the use of VWU staff and “community volunteers” at the district and commune levels. Weaknesses in financial management include: (a) the calculation and analysis of performance and financial ratios; (b) the strategic planning process and preparation of financial projections; and (c) budgeting.
- Decree 28 will enable licensed MFIs to access capital from individuals and organizations inside and outside of Viet Nam. However, it is questionable whether the current level of MFOs’ finances and the quality of their reporting will be adequate to meet the documentation requirements of commercial banks. It is also unclear whether MFOs’ performance is sufficiently transparent and profitable to attract private investors and investment funds.
- Another key issue relates to potential donor funding available for transformation and adherence to requirements of the decree. Beside the minimum legal capital required, MFOs planning to register with the SBV will need a substantial amount of money to invest in hiring specialized staff, upgrading their existing systems, renting adequate office space, etc.

## **VI. Recommendations**

### ***Enabling Environment***

- *Conduct a comprehensive inventory of the different microfinance schemes in Viet Nam to improve publicly available information about the sector.* The information would help the State Bank of Viet Nam (SBV) and Ministry of Finance (MOF) in the drafting of the implementing circulars. It would also serve as the basis of a comprehensive strategy for the development of the microfinance sector in Viet Nam.

- *Technical assistance to the State Bank of Viet Nam (SBV) and Ministry of Finance (MOF) on implementation of Decree 28.* Training should be provided on microfinance principles and best practices for all SBV and MOF staff that will be directly involved in the drafting of the circulars and eventual supervision of registered MFIs. Former and/or current regulators and supervisors from countries with a more mature microfinance industry could be tapped as technical advisors.
- *Develop national strategy for microfinance.* Issues to be considered in the strategy include: (a) integration of the microfinance sector into the overall financial system; (b) promoting a competitive and transparent market for microfinance; and (c) enabling the participation of a wide range of institutional players in the microfinance market.

### ***Capacity Building for MFIs***

- *Establish a formal training curriculum for microfinance.* It is essential for the microfinance sector in Viet Nam to develop a local infrastructure for microfinance best practices' training. Targeted beneficiaries of training would be: (a) MFI staff at all levels, and (b) MFI boards of directors. The sector could take advantage of existing courses developed by CGAP<sup>1</sup>, MicroSave Africa, ILO, and other organizations. The training providers should be commercially-oriented and ideally, should come from the private sector rather than be under the auspices of the government.
- *Transformation of the Microfinance Working Group into a formal professional association.* The microfinance sector in Viet Nam needs a formal national association, a member-based organization that provides services to MFOs and acts as the representative voice for the sector. Key roles of the association would include: (a) performance monitoring and benchmarking; (b) facilitation of training and technical assistance; (c) coordination of funding opportunities; (d) advocacy and awareness-raising; and (e) research and development.

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<sup>1</sup> CGAP: Consultative Group to Assist the Poorest, CGAP is a consortium of multilateral and bilateral donor organizations that aims at promoting best practices in microfinance.

## **I. INTRODUCTION**

The United Nations has declared the year 2005 as the “International Year of Microcredit” due to its significant contribution to poverty reduction and economic development throughout the world. In addition, the Millennium Development Goals have set out the objective that “in 2015, there will be 175 million poor, especially women and their family, who will have access to small loans in order to pursue income-generating activities, create employment, and improve livelihoods.”

In Viet Nam, microfinance has made an important contribution to meeting the objectives of the country’s Comprehensive Poverty Reduction and Growth Strategy (CPRGS). On March 9, 2005, the Government of Viet Nam (GoVN) enacted Decree 28, Decree on the Organization and Operation of Microfinance Institutions, in order to create a legal framework for this fast-growing activity.

Nevertheless, the level of awareness and understanding about microfinance varies greatly among policymakers and regulatory and supervisory entities. Moreover, microfinance organizations (MFOs) lack the technical skills necessary for the professionalization of the sector, and have limited capacity to access sufficient funding to continue their operations. It is important therefore to highlight the achievements of microfinance and to discuss how to further promote the development of the sector in Viet Nam.

The International Labour Organization (ILO) has commissioned this discussion paper on microfinance in Viet Nam in order to increase stakeholders’ knowledge about the sector and to raise the challenges facing the sector in the next five years. The paper aims to provide recommendations regarding the legal and regulatory environment, access to capital, and capacity building issues in an effort to overcome these challenges and enable the transformation of microfinance into a professional and sustainable industry that adheres to international best practices.

Due to limited time and resources, this discussion paper is not meant to be a comprehensive review of the microfinance sector. Rather, the paper focuses specifically on semi-formal microfinance organizations (MFOs) that are the subject of Decree 28.

### **Research Methodology**

The findings of this paper are based on a desk review of existing literature as well as direct discussion with the relevant organizations working in the Vietnamese microfinance sector. Documents reviewed include program evaluations, technical assistance reports, and impact assessments conducted by local and international consultants; other resource documents, government policies and regulations related to the national poverty reduction program and to microfinance activities<sup>2</sup>.

In June 2005, two focus group discussions (FGD) were held with policymakers and microfinance providers in Ho Chi Minh City and Ha Noi in order to collect information, suggestions, and opinions about the state of the microfinance sector. During the FGDs, participants were asked to comment on the state of the microfinance sector and the impact that it has made in Viet Nam, followed by a discussion of the challenges/ difficulties facing the sector, and recommendations for the future development of the sector. In addition, a written questionnaire was sent to a separate group of policymakers, donors, and microfinance practitioners for additional feedback.

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<sup>2</sup> A list of reference documents is provided in Annex 1.

## **II. MICROFINANCE IN VIETNAM**

### **II. A. What Is Microfinance?<sup>3</sup>**

Traditionally, microfinance was viewed as a “credit methodology that employs effective collateral substitutes to deliver and recover short-term, working capital loans to microentrepreneurs (or potential microentrepreneurs). The vision was that microenterprises of clients would grow, increasing their incomes and sometimes creating employment, lifting the poor out of poverty.”<sup>4</sup> Over time, several lessons were learned by practitioners and donors: (a) microfinance needs sustainable institutions with the right organizational structure, staffing, and operational systems and procedures; (b) microfinance needs an enabling legal and regulatory environment to ensure a level and competitive playing field; and (c) the poor need a variety of financial services beyond credit, such as deposit services, money transfers, and insurance.

In Viet Nam, the core product remains credit though several organizations are starting to expand their product offerings. Microfinance loans are usually used to invest in (a) small-scale farming such as growing fruit or vegetable, raising livestock, (b) services such as construction, auto repairs, beauty salon, (c) fishing and aquaculture, (d) small handicrafts, or (e) small commerce. The loan amount tends to be smaller (ranging from USD 50-500) and the nominal interest rate higher than commercial bank loans (ranging from 1-2% per month). The small loan amount makes it easier for clients to manage their debt and repayment, while the higher interest rate allows the microfinance provider to cover the higher costs of lending to the poor. Experiences from around the world have found that (a) the poor value access to credit and are willing to pay more for this access; (b) microfinance programs need to charge an interest rate at a sufficiently high level to cover, at a minimum, their operating costs in order to continue providing these loans on a long-term and sustainable basis; and (c) the interest rate on microfinance loans is still lower than those charged by informal moneylenders (as high as 10% per month).

### **II. B. Suppliers of Microfinance in Viet Nam**

In Viet Nam, microfinance providers can be grouped into three main categories: formal sector, semi-formal sector, and informal sector. This section provides a brief summary of how microfinance was introduced in Viet Nam, followed by an overview of the institutional players in each of the categories.

In the late 1980s, in conjunction with the introduction of Viet Nam’s “doi moi” reforms, microfinance was introduced to Viet Nam through international organizations (IO), international non-governmental organizations (INGO), and official development assistance programs of bilateral and multilateral donors. While all these programs had the same objectives of hunger eradication, poverty reduction, and income parity, they varied greatly in implementation approach. Some projects had the sole objective to provide microfinance services, while others implemented a microfinance component as part of a broader program. There also existed several programs that viewed the provision of microfinance as a strictly

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<sup>3</sup> The 11 Key Principles of Microfinance are provided in Annex 2. These principles were developed by the Consultative Group to Assist the Poorest (CGAP), a consortium of multilateral and bilateral donor organizations that aims at promoting best practices in microfinance.

<sup>4</sup> CGAP Phase III Strategy, 2003-2008.

social tool aimed at assisting a targeted segment of the population during a limited period of time.

In the early 1990s, the GoVN established its national poverty reduction and hunger eradication program, where credit was considered to be one of the strategic tools. The government-supported credit was channeled either through the traditional banking system (Viet Nam Bank for Agriculture and Rural Development, VBARD), through a subsidized policy lending institution (Viet Nam Bank for Social Policies, VBSP<sup>5</sup>), or through targeted preferential loan programs.<sup>6</sup>

Socio-political organizations, especially the Viet Nam Women's Union (VWU), became an important partner of the credit projects run by the banks, IOs, and national programs. The VWU successfully implemented many microfinance programs due to the depth and scale of its network, especially in the rural areas, and the commitment of its staff. However, as will be further discussed below (Section II.C), this collaboration with socio-political organizations also came with its own challenges.

### ***1. Formal Sector***

In the formal sector, two financial institutions dominate the provision of microcredit in Viet Nam: VBARD and VBSP. According to the 2005 Living Standards Survey conducted by Viet Nam's General Statistics Office (GSO), VBSP provided credit to 58.3% of the surveyed rural poor households, while VBARD provided loans to 23.8% of the surveyed rural poor.

***Viet Nam Bank for Agriculture and Rural Development (VBARD)***. Since 2003, VBARD has transferred its poverty lending activities to the VBSP, although the institution is still implementing credit lines funded by international donors through Official Development Assistance (ODA) as well as other government-directed credit programs. VBARD's loans are accessed primarily by rural farmers. Loans below VND 10 million (USD 650)<sup>7</sup> do not require collateral if the applicant is sponsored by the Women's Union or the Farmer's Union. Loans above VND 10 million require collateral. Loan terms are typically 6 months, and renewable for another 6 months. Interest rates range from 0.8 to 1.2 percent per month, depending on the current market rate. Repayment formulas vary from lump sum to regular installments. Debt rescheduling is not uncommon, but a higher interest rate applies to arrears.<sup>8</sup>

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<sup>5</sup> Formerly Viet Nam Bank for the Poor (VBP).

<sup>6</sup> In the GoVN's development strategy, many localities focused on hunger eradication and poverty reduction (HEPR). The first HEPR Fund was established by Ho Chi Minh City in 1992, eventually expanding to 44 provinces nationwide, in order to mobilize and provide development assistance to poor households. This assistance aimed primarily at providing loans at subsidized interest rates to the working poor. These activities were officially recognized by the GoVN and MOLISA was given the responsibility to oversee and monitor these programs. The Ministry established the official poverty indicator in 1993, and in that same year, the GoVN launched several national HEPR programs such as non-collateral lending through the HEPR Fund and VBARD, Program 327 (reforestation and resettlement), and Program 120 for job creation (originally managed by MOLISA, subsequently transferred to VBSP). In 1998, the National Strategy for Hunger Eradication and Poverty Reduction (Program 133) was established, consisting of several components such as credit assistance, free tuition support, free health services for the poor, agriculture, forestry, fishery promotion, and resettlement. Between 1996 and 2002, the GoVN committed VND 14,695 billion for the provision of subsidized credit to 2.75 million households.

<sup>7</sup> A conversion rate of VND 15,500 to USD 1 will be used in this paper.

<sup>8</sup> World Bank (2003), *Viet Nam Development Report 2004*, Report No. 27130-VN.

***Viet Nam Bank for Social Policies (VBSP)***. The VBSP was created in 2003 to take over the small-scale policy and directed lending programs previously administered by the State-Owned Commercial Banks (SOCBs) and other government entities, including the former Viet Nam Bank for the Poor (VBP). The Bank has established 61 branches and 600 transaction offices throughout all 64 provinces of the country. The primary goal of the VBSP is to provide preferential credit to poor households, as well as people and organizations eligible for social benefits and policies. For poor households, the maximum loan amount without collateral is VND 7 million (USD 450), and VND 10 million (USD 650) maximum with collateral. The interest rate is 0.5 percent per month, and 0.45 percent in difficult and mountainous regions. The loan terms are based on the business plan of the borrower but usually do not exceed 5 years. Repayments are made monthly or quarterly, depending on negotiations between the bank and the borrowers. For small loans, the loan principal is due at the end of the loan.<sup>9</sup> At the end of December 2004, the VBSP's total outstanding loan to poor households was VND 11.3 trillion (USD 730 million), with an average loan size of VND 3.6 million (USD 232).

There are two other notable institutional players in the formal sector serving poor and rural households:

- ***People's Credit Funds (PCFs)***. The PCFs were first established in 1993. They are modeled on the *Caisse Populaire* system in Quebec, Canada. The PCFs are commune-based rural credit institutions that provide financial services to local farm households. By December 2004, the system of PCFs comprised 905 funds operating at the communal, regional and central levels, with 966,540 members. The total outstanding loan amount was VND 5.1 trillion (USD 330 million), with an average loan size of VND 5.3 million (USD 342). The PCF's interest rates range from 1.1 to 1.3 percent a month.<sup>10</sup>

- ***Viet Nam Postal Savings Service Company (VPSC)***. The VPSC was established in 1999 and is operated under the authority of Viet Nam Post and Telecom (VPT). Its main functions are to provide a savings product for the underserved (rural, women, and poor) populations of Viet Nam and to mobilize savings for government development investments. In 2001, the Company had 539 branches; 500,000 deposit accounts, and VND 3.8 trillion (USD 245 million) in outstanding savings, with an average savings amount at VND 7.6 million (USD 490).<sup>11</sup>

## ***2. Semi-Formal Sector***

Semi-formal microfinance providers consist of programs sponsored by NGOs (local and international) and those established by socio-political organizations. These microfinance organizations (MFOs) are considered "pro-poor" and aim to provide a wider and more appropriate range of financial services than the formal sector.<sup>12</sup>

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<sup>9</sup> World Bank (2004), *Financial Sector Policy Issues Note: Viet Nam Bank for Social Policies*.

<sup>10</sup> Information received through telephone interview with PCF representative.

<sup>11</sup> World Bank (2002), *Banking Sector Review: Viet Nam*.

<sup>12</sup> World Bank (2003), *ibid*.

While no comprehensive survey of the sector has been conducted since 2001, the World Bank's 2004 Development Report estimated that some 57 international NGOs are supporting microfinance activities in Viet Nam. In addition, there are two major government-related microfinance organizations: (i) the *Tao Yeu May/Compassionate Fund* (TYM) established by the VWU in 1992 and (ii) the Capital Aid Fund for Employment of the Poor (CEP) established by the Labour Confederation in Ho Chi Minh City in 1992. TYM and CEP also represent the two leading MFOs in Viet Nam in terms of size and performance.<sup>13</sup>

At the end of 2004, there are MFOs operating in 36 provinces (57%), 132 districts (23%), and 2,900 communes (27%) of the country, reaching a total of 351,298 clients. Total assets of these microfinance programs amount to VND 396,618 million (USD 25.6 million), with a total outstanding loan portfolio of VND 369,309 million (USD 23.8 million) and total mobilized savings of VND 120,210 million (USD 7.8 million).<sup>14</sup> The average loan size for MFOs is VND 1.05 million (USD 68) and the average outstanding savings amount is VND 342,000 (USD 22).

The level of outreach attained by MFOs is insignificant when compared to the 2.5 million borrowers being served by the VBSP and VBARD. However, MFOs tend to serve the more remote rural areas of Viet Nam where the formal sector is unable or unwilling to go.<sup>15</sup> Secondly, these organizations usually rely on a limited pool of international donor funding in order to expand their operations since they have not been allowed legally to access commercial funding until now.<sup>16</sup> Thirdly, in localities where MFOs compete directly with VBSP and VBARD, studies show that MFOs tend to reach a larger number of poor households (see discussion in section II.D.2 below). Fourthly, if one were to use average loan size and average savings amount as a rough proxy, one could see that MFOs come out the lowest when compared to institutions in the formal banking sector.

**Women's Savings Group system**

Since 1991, learning from the experience of Self-Help Groups in neighboring countries like Indonesia, the Viet Nam Women's Union has established Women's Savings Group (WSG) as a means to create a self-managed revolving fund at the commune level. By December 2004, there existed over 151,464 WSG in 98% of communes in the country, with a total of 2,920,219 members. The Union successfully disbursed loan of Program 120 (*cf. footnote no.5*) and other national programs. The savings and credit system run by the VWU has contributed considerably to the government's poverty reduction goals. The Government of Viet Nam recognized this record and allowed the VWU to continue supporting WSGs (*Notice No. 01 of the Prime Minister, dated January 4, 2000*). SBV also issued a legal document permitting WSGs to operate under the leadership of VWU (*Document No. 699 CV/NHNN, dated July 28, 2000*).

<sup>13</sup> Two other government-recognized MFOs are the Pro-Poor Center (PPC) based in Ha Tinh province and the Promotion of Women Development Fund in Uong Bi town, Quang Ninh province.

<sup>14</sup> This information is based on information submitted to the Micro Finance Working Group (MFWG), an informal association of microfinance practitioners whose main objective is to promote mutual learning and information exchange among microfinance stakeholders in Viet Nam. It should be noted that these totals may not reflect *all* microfinance schemes currently operating in the country.

<sup>15</sup> The main target clientele for the MFOs are: (a) poor households; (b) ethnic minority groups; and (c) households living in remote and under-developed areas. MFOs focus specifically on reaching out to the women within these groups.

<sup>16</sup> Under Decree 28 on the organization and operation of microfinance institutions, licensed MFIs will be able to receive trusted capital and investments from individuals as well as organizations.

There are three typical credit methodologies used by these MFOs:<sup>17</sup>

- **Grameen Bank replica.** The Grameen Bank methodology was originally developed by the Grameen Bank in Bangladesh to support rural women for income generation activities. Under this methodology, clients form groups of five members, with each person acting as a guarantor for other persons in the group, to get loans. Organizations following this methodology in Viet Nam include CEP, TYM, ActionAid, Viet Nam-Belgium Credit Project (VBCP), and CIDSE (Coop ration Internationale pour le D veloppement et la Solidarit ).
- **Village Bank.** This methodology was developed in the mid-1980s by the Foundation for International Community Assistance (FINCA). Under this methodology, clients form groups of at least 15-20 members, loans are divided equally among members, and each member owns a “share” of the bank. Organizations that have applied this model include Netherlands Development Organization (SNV), Plan International, World Vision International (WVI), and International Fund for Agricultural Development (IFAD).
- **Solidarity group.** This methodology was developed by ACCION International in Latin America. Under this methodology, loans are provided to groups of 4-7 members rather than individuals, with the members dividing the loan equally among themselves. In Viet Nam, implementers of this model include Save the Children/US (SC/US) and Adventist Development and Relief Agency (ADRA).

While MFOs provide a wide range of credit products, most clients start out with the basic credit product - the short term working capital loan. Loan amounts range from VND 200,000 (USD 6.50) to VND 5 million (USD 300). Interest rate ranges from 0.9 percent to 2 percent a month. The loan term varies from 6 to 12 months, but never exceeds 24 months. Repayment can be made on a weekly, bi-weekly, or monthly basis.

Common credit policies followed by these MFOs include:

- group guarantees instead of collateral to minimize credit risk
- disciplined and strict monitoring system to verify loan use and ensure full and on-time repayment
- short-term loans, in successive cycles of increasing loan amounts
- savings requirement as a condition for the loan
- repayment is divided into equal small installments that include interest and capital
- interest rate at sufficiently high level to cover operational costs
- regular participation in group/center meetings

### 3. Informal Sector

In the informal sector, there are three different types of credit providers to poor households:

- **Ho/Hui.** Ho/Hui are popular forms of rotating savings and credit associations (ROSCAs) in Viet Nam that have existed for generations but have never been recognized

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<sup>17</sup> Nguyen Thanh An (2004), *Notes from Preliminary Review on Microfinance for Poverty Reduction in Viet Nam*, Ford Foundation.



officially.<sup>18</sup> *Ho/ Hui* are credit and savings groups of 5 to 20 members, established on a voluntary basis by a group of individuals. Each group mobilizes savings from its members and provides loans only to members. Savings can be made in cash ranging from VND 50,000 (USD 3.5) to VND 1,000,000 (USD 64) on a monthly basis, or in-kind (such as rice for farmers) on a seasonal basis of 4-6 months. Decisions on interest rates, membership, and loan amounts are either made jointly by all members, by a bidding process, or solely by the organizer/owner of a *Ho/Hui*. Two common types of *Ho/Hui* are “credit type” and “supportive type”- the former aiming to earn additional income from interest, while the latter aiming to facilitate mutual assistance among participants. There is no official data on the number of *ho/hui* groups that exist, or the total amount mobilized by members.

- ***Relatives, friends and neighbors.*** Loans from friends and relatives take flexible forms, are normally without interest rate, and usually depend on the personal relationship between borrowers and lenders, or income source of borrowers.
- ***Moneylenders.*** There are three types of private moneylenders.<sup>19</sup> The “traditional” type of money lending involves lending based on mutual confidence, using simple procedures without any written loan contracts. Such traditional loans are typically short-term lending in cash, sometimes just for a few days. A second type of money lending is through pawn shops, which is similar to the first type, but the lenders require borrowers to have assets or land as collateral. The third type of private money lending is through small traders, input suppliers and marketing agencies in local areas. This type of lending is increasingly common and may be in cash or kind. The private moneylender is characterized by diverse, flexible operations. Their loans usually are small scale as well as short-term (specified by season or by days). The loan rates range from 4 percent to 10 percent per month.

## **II.C. Distinguishing Characteristics of Microfinance in Viet Nam**

There are three characteristics that distinguish the microfinance sector in Viet Nam from models in other countries.

### ***1. Involvement of Socio-political Organizations in Microfinance***

In most countries, NGOs were the “pioneers” behind the microcredit technology. In Viet Nam, the movement was implemented through the existing apparatus of the Communist Party. This approach has both advantages and drawbacks. On the positive side, the wide-reaching network of the VWU and other socio-political organizations (SPOs) made it possible to reach poor clients in rural areas more effectively than in other countries. On the other hand, the close affiliation with SPOs meant that microfinance activities were often seen as government-supported social welfare programs rather than economic development and business oriented local institutions.

Besides, most microfinance programs were embedded in the overall organizational structure and operational policy of the SPO. For example, even though TYM is considered a separate “department” within the VWU, decisions about its strategic direction, budgeting, and human

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<sup>18</sup> *Ho* is popular in the North while *Hui* is the term used in the South.

<sup>19</sup> McCarty, Adam (2001). *Microfinance in Viet Nam: A Survey of Schemes and Issues*. Report prepared for DFID and SBV, Ha Noi, Viet Nam.

resources are subject to the approval of the Central VWU’s leadership. TYM’s inability to make independent policy decisions means that the organization has less flexibility to innovate and respond to client demand, and is unable to mobilize adequate resources to make investments in their human and physical infrastructure.

The table below raises some additional strengths and challenges in working with the VWU on microfinance.

**Table1. Partnership with the VWU: Strengths and Challenges**

Strengths	Challenges
No need to recruit new staff for program	VWU cadres may lack the appropriate skills to run a sustainable microfinance program
VWU cadres already familiar with locality and the economic situation of its members	VWU’s social and political orientation may not be compatible with program’s objective of financial sustainability
Program can be implemented and outreach can be achieved fairly quickly	Priority may be placed more on number of clients rather than on quality of loan
Take advantage of existing organizational and reporting structure to implement program	VWU cadres may not be allocated to the microfinance activity on a full-time basis, which could affect the loan monitoring process

## ***2. Rural vs Urban-based Microfinance***

A second distinguishing characteristic of the Vietnamese microfinance sector is that the majority of clients are rural-based.<sup>20</sup> This is unlike other countries with an active microfinance sector, where the majority of organizations are located in urban centers. The involvement of the VWU allows the microfinance program to minimize operating costs by relying on the existing structure rather than on a – costly - branch or distribution network.

## ***3. State-supported Policy Lending Bank***

A third distinguishing characteristic of microfinance in Viet Nam is the existence of a formal policy lending bank in the microfinance market, VBSP. The decree that created the VBSP<sup>21</sup> has in effect created a non-profit bank that offers a full range of financial products and services at subsidized rates. In addition, the bank is exempt from many of the regulatory provisions that govern the operation of the SOCBs and will not be covered by the proposed regulatory framework for microfinance institutions (MFIs).<sup>22</sup>

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<sup>20</sup> CEP is the exception as their clients are primarily based in urban areas of Ho Chi Minh City. Out of CEP’s 16 branches, 9 branches serve clients in urban districts and 7 branches operate in rural districts of the city.

<sup>21</sup> The VBSP was established under Decision 131/2002/QD-TTg of October 4, 2002, with the charter approved on January 22, 2003 (Decision No. 16/2003/QD-TTg).

<sup>22</sup> World Bank (2004), *ibid.*

The VBSP's capital base has been substantially widened since its creation in 2003. The bank reportedly received VND 1.515 trillion (USD 100 million) in charter capital from the state budget and is scheduled for an additional infusion of VND 3.5 trillion (USD 230 million) in charter capital. The institution's funding is further supplemented by a mandatory contribution of 2 percent of VND deposits from the SOCBs.<sup>23</sup> At December 2004, the VBSP had a total capital of VND 15.4 trillion (USD 994 million).<sup>24</sup>

With this vast capital resource base, the VBSP is positioned to take a dominant share of the microfinance market. However, the preferential lending rate used by the VBSP has the potential to cause two unhealthy effects: (a) crowd out current MFOs from the market and discourage commercial banks and new MFOs to enter the market; and (b) reinforce the subsidy-dependent attitude of poor households. The crowding out of current MFOs and potential new commercial entrants into the microfinance sector results in an uncompetitive market for financial services to the poor, while the subsidized lending rate means that the VBSP will not be able to recover its costs and will have to rely continually on public funding to continue operating.

Besides the poverty lending program, the VBSP is mandated to implement several government policy programs, including scholarships for poor students, credit for job creation, and financial assistance for migrant workers. The bank reports that 97 percent of its outstanding loan portfolio is for poor households but does not provide the total number of clients being served.

## **II. D. Achievements and Impact of Microfinance in Viet Nam**

The "impact" of microfinance is usually assessed at two levels: the first deals with the effectiveness of MFOs in providing access to financial services for the poor; and the second deals with the socio-economic impact of microfinance on the client, the household, as well as the local community.

### ***1. Increasing Provision of Financial Services to the Poor***

***Creating an alternative financial services network for the poor.*** The appearance of microfinance models, especially the creation of semi-formal MFOs, has changed the financial services landscape. In the past fifteen years, semi-formal MFOs have created an alternative delivery channel to the formal financial sector. MFOs usually target localities that are underdeveloped—i.e. lacking arable land, infrastructure and roads, vulnerable to floods and natural disasters, etc—and the primary client segment tends to be women. For example, 90% of the clients served by the Women's Assistance Fund in Son La are ethnic minority women. On average, poor households comprise above 70% of the total clientele of MFOs.

While MFOs are considered semi-formal, this does not mean that their operations are unstructured. Their financial services are in fact provided through a formal organizational structure with specific credit policies and procedures, monitoring systems, and accounting procedures that are based on international best practices, and are sometimes stricter than those used by commercial banks.

Program evaluations conducted in several districts show that MFOs serve a poorer segment of the society than the formal sector in these particular districts. For example, the Savings and

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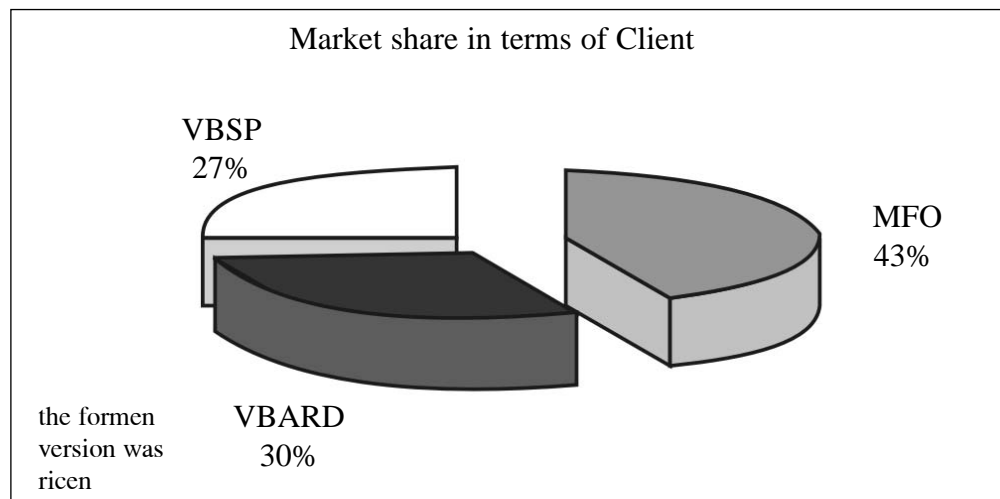
<sup>23</sup> VBSP is getting a negative return on these funds since the interest rate on SOCB deposits is at 0.65% per month, and the VBSP onlends to its subsidized clients at 0.5% per month.

<sup>24</sup> VBSP (2005), Report Summarizing 2004 Activities and Plan for 2005.

Credit Organization (SCO) in Ba Thuoc district of Thanh Hoa province, currently serves 48.1% of poor households, compared to 27.2% for VBSP and 47% for VBARD. In difficult localities like mountainous and remote regions, MFOs tend to reach an even larger number of poor households—52% in Mai Son district of Son La province, and 47% in Dong Trieu district of Quang Ninh province, compared to 42% served by VBARD and VBSP combined in Son La and 26% in Dong Trieu.

Using data from 7 MFOs currently operating in 60 communes in mountainous and difficult regions, figure 1 below shows that the percentage of clients borrowing from MFOs is 43%, compared to 27% for VBSP, and 30% for VBARD.

**Figure 1: Market Share by Lending Institution in 60 Communes Served by MFOs**



The chart above also illustrates that even though two formal financial institutions (VBARD and VBSP) are providing microfinance services in these 60 communes, the demand has not been met and the microfinance organizations share a significant part of the market.

Since the VBSP has strict disbursement periods and irregular disbursement cycles, most poor households have little opportunity to borrow from VBSP. VBARD tends to give larger-size loans which may not be appropriate for certain poor households. This confirms the role of micro-finance as an inseparable part of the financial service system.

***Meeting the financial services needs of the poor through a client-centered approach.*** MFOs, due to their affiliation with socio-political organizations like the VWU, tend to have an organizational structure at several levels, from group (*nhom*) to center (*cum*) to village (*thon*) to commune (*xa*) to district (*huyen*) to province (*tin*h), whereas the formal sector operates through branches as far down as the commune level. MFO staff come from and are based in the local community which mean that (a) clients have easier, quicker, and more convenient access to financial services, (b) staff can monitor more effectively and be more responsive to client demand.

In participatory assessments with the local population in several districts, clients usually rate MFOs number one in terms of product and service quality, with VBARD coming in second and VBSP coming in third. Product and service quality comprises loan requirements, loan size, interest rate, loan term, loan procedures, and repayment terms. Some of the reasons for the higher client rating may be (a) the loan products offered by MFOs are more appropriate to the poor's needs and capacity to repay, and (b) MFOs are located closer to the community and can

provide easier and more convenient access to credit. Another important reason for higher customer satisfaction with MFOs relates to the availability of a wide range of products and services. Besides short-term working capital loans, MFOs also provide supplementary/emergency loans, seasonal loans, as well as medium to long-term loans for larger size investments. CEP, for example, is pilot testing a housing loan, while TYM provides a micro-insurance product through its Mutual Assistance Fund that enables clients to receive certain benefits in case of death and/or illness in the family.

MFOs are often the main channel for mobilizing savings from the poor since they are community-based and willing to accept very small deposits. The minimum deposit at commercial banks in Viet Nam is VND 100,000 (USD 12) and VND 50,000 (USD 3) at Postal Savings Bank, whereas the average savings transaction at TYM is VND 10,000 (USD .60). In client surveys conducted by the microfinance program in Dong Trieu district of Quang Ninh province in August 2002, nearly 89.2% stated that they participate in the program in order to access the savings service, with only 10.8% stating that they participate mainly to access loans.

Non-financial services represent an important component of MFO activities. These include training on basic business skills and information about healthcare, reproductive healthcare, child nutrition, etc. Clients stated that the main difference between MFOs and VBARD related to the level of follow-up training and technical assistance provided by the MFO *after* loan disbursement, a service that clients highly value since it helps them to improve their business management skills and to use their loan more effectively.

## ***2. Socio-Economic Impact***

Results of evaluations conducted on microfinance programs in Viet Nam show that the management and technical skills levels vary greatly from one program to another. However, in terms of impact, the majority of assessments have found that microfinance has played an important role in socio-economic development.

***Diversification of poor households' income source to reduce economic vulnerability and risk.*** Microfinance loans allow poor households to expand their existing economic activity and increase their income. For instance, 34% of World Vision International clients used their loan to increase their level of production, while TYM client surveys showed that clients who previously never left their village are now selling their products at several provincial markets. By diversifying their sources of income, poor households not only increase the overall income level, but also reduce their risk should the local market experience a downturn. The increased income helps poor households to meet unexpected expenses in case of accident or illness. In addition, the compulsory savings component of microfinance programs encourages and teaches clients to put a little amount of money aside on a regular basis in order to improve their ability to cope with unforeseen risks, either in their daily life or in their business.

***Contribution to attaining the national objective of hunger eradication and poverty alleviation.*** The majority of assessments conducted on microfinance programs in Viet Nam found that microfinance has helped the poor to increase their livelihood and improve their quality of life.

(a) Impact assessments conducted by CEP, World Vision International, and the microfinance program in Ki Anh district of Ha Tinh province, all show an increase in the number of client households moving from the “poorest” category to become medium poor or less poor after five years. Incidents of malnutrition also decreased among client households compared to non-client households.

(b) Impact assessments show that clients’ housing improves and the level of new asset purchase increases over the time the client participates in a microfinance program. Most households participating in microfinance programs have switched from a straw to an adobe or brick house.<sup>25</sup> In addition, families were able to buy household items like fans, radios, televisions, beds, and transportation vehicles like bicycles or motorbikes.

(c) Access to microfinance helps to increase revenue, which means that poor households are in a better position to pay for their family’s medical care and their children’s school fees. Without this additional income, poor households often have to tap into their savings, borrow from families and friends, or worse, sell off some of their assets.

***Increased participation and contribution of poor people to country’s economic production.***

A microfinance loan helps to increase the effectiveness and value-added of poor households’ economic activity, thereby increasing poor households’ participation in and contribution to the country’s economy. Because clients are required to repay part of the loan principal at each installment, a microfinance loan teaches the poor to diversify their income generating activities and to manage their income flow carefully in order to meet their financial obligations. A microfinance loan also helps clients to expand their existing productive activity and create jobs for their community. For example, several long-term clients of the TYM fund are now running small enterprises that employ non-working members of their community, including those from low-income households.

***Empowerment of women by raising their role and status within their own household as well as the community.***

A microfinance loan allows women to gain more control over their household’s economic situation. The loan gives her a sense of financial independence and enhances her decision making role in the family. Female clients also learn how to interact with a financial institution, an important first step in building clients’ ability to access services from the formal financial sector. Through the regular group meetings, female clients acquire business skills as well as information on health, nutrition, etc. that help them run their economic activity and their household smarter and more effectively.

***Capacity building for socio-political organizations.*** Building the technical skills of local partners is a necessary condition and objective of all microfinance programs. The VWU, in particular, has benefited the most since they tend to be the preferred implementing partner of microfinance programs. VWU staff has acquired new skills and competence related to microfinance principles, organizational development and financial management.

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<sup>25</sup> Based on impact assessment studies conducted by SC/US Microfinance Program in Nong Cong District (December 2003) and TYM’s Report on Ten Year of Operation (2002).

### **III. CHALLENGES FACING THE MICROFINANCE SECTOR IN VIET NAM**

While the microfinance sector has made important strides towards international best practices, and current microfinance providers have had notable social and economic impact on poor households and micro-entrepreneurs, several barriers and constraints remain, which are hampering the sector's ability to reach its full outreach potential and achieve financial viability. For example, when comparing CEP to ACLEDA (Association of Cambodia Local Economic Development Agency), one of the leading MFIs in Cambodia established in 1993, one can see the major contrast in outreach. ACLEDA has nearly USD 40 million in outstanding loan capital while CEP has only USD 5.2 million (see Annex 3). In terms of profitability, CEP is shown to outrank ACLEDA and its Philippines counterpart CARD (Center for Agriculture and Rural Development), with a Return on Assets (ROA) of 9.2% compared to 4.93% for ACLEDA and 1.45% for CARD. CEP's operating expenses, however, are underestimated due to hidden subsidies that exist from its partnership with the Labour Confederation. Eventually, these subsidies will have to be taken into account and adjusted to provide a more realistic picture of CEP's performance.

This paper classifies challenges facing the Vietnamese microfinance sector into three categories: (a) issues related to the role of government in microfinance and the policy and regulatory environment, (b) issues related to the internal capacities of current microfinance providers, and (c) issues related to the availability of external funding for growing microfinance institutions.

#### **III. A. Enabling Environment for Microfinance**

One of the key principles of microfinance is that national governments should play the role of enabler or facilitator rather than a direct provider of financial services<sup>26</sup>. By creating a supportive policy environment, the government can help to promote the growth of a healthy and viable financial system for the poor. Important elements of such an environment include a stable macroeconomic environment, the absence of interest rate ceilings, and the elimination of subsidized loan programs. Household and rural enterprises also benefit from government improvement of basic infrastructure such as roads, electricity, and telephone lines. Government involvement in funding microfinance institutions can only be justified in cases where capital is not available or readily accessible to local institutions.

##### ***1. Government Awareness and Support of Microfinance***

In Viet Nam, the government has traditionally channelled funding through state-owned financial institutions such as VBARD and VBSP for the purpose of dispensing subsidized credit to the rural areas as part of its poverty reduction strategy. While VBARD has transformed itself into a commercial bank since 1995, with the assistance of several international donors, VBSP remains the government's vehicle for policy lending.

The existence of these two lending institutions in the microfinance market has resulted in an uneven playing field and non-competitive market by crowding out private and commercially-oriented microfinance lenders. The continued disbursement of preferential lending is further

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<sup>26</sup> See CGAP's 11 Key Principles of Microfinance in Annex 2.

reinforcing the subsidy-dependent attitude of poor borrowers, i.e. the poor should not have to and cannot afford to pay market rate for credit.

While in principle, the government has removed the interest rate ceiling on loans, the fact that it continues to support the use of subsidized loans through VBSP has hampered the ability of commercially-oriented financial institutions, including banks, to compete effectively. The active role of the government in the Vietnamese microfinance market is probably due to:

- a low level of government awareness at the national and provincial level regarding international best practices in microfinance;
- the long-held perception by the government that microfinance is a humanitarian tool for poverty reduction, rather than an economic tool for expanding access to sustainable financial services by the poor; and,
- the unavailability of information regarding current MFOs in terms of their targets and objectives, lending methodologies, institutional structure, and performance.

The enactment of Decree 28 on the organization and operation of microfinance institutions could be interpreted as recognition on the part of the government that microfinance is a “business” with a social mission that has to be run in a financially sustainable way. In reality, it is unclear whether the initial drafting of the decree and its eventual issuance came about as a result of pressure from international donors, such as ADB, and semi-formal MFOs, or based on a broader official government strategy or policy. Focus group discussions held with ministry representatives in June 2005 indicated that the level of knowledge about microfinance remains low among government officials, even within the State Bank of Viet Nam (SBV) and the Ministry of Finance (MOF). Moreover, the decree establishes strict requirements concerning the establishment and operations of MFIs but contains no provisions to correct the distortionary effects of subsidized lending.

## ***2. Implementation of Microfinance Decree 28***

In general, the decree is expected to have a positive impact on the growth of the microfinance sector in Viet Nam. The decree will enable the formalization and professionalization of microfinance operators in the semi-formal sector. By granting MFOs a formal legal status, the decree will facilitate MFOs’ ability to access external financing in order to increase their capital base for further growth and expansion. The decree also paves the way for the entrance of new actors into the market.

One major issue that the decree did not address is the role of the government in the sector. The fact that each application for a license will be subject to approval by the provincial or city-level People’s Committee, including application for opening a new branch, means that the government will continue to play an influential role in deciding which organizations can provide microfinance services and where they can operate. For example, the People’s Committee could hold up an MFO’s application or give priority to certain government-sponsored microfinance programs. While the ultimate approval lies with the SBV, it is expected that the endorsement of the People’s Committee will be a central element in an MFI’s licensing dossier.

Moreover, historical experience from the implementation of other Vietnamese decrees indicate that provincial authorities lack capacity and need clearly-defined guidelines from the central government level for effective implementation. There also tend to be different interpretations,



and oftentimes, subjective assessments of laws and regulations, which lead to an inconsistent application of these laws. Thus, it is crucial that the related circulars for this decree be issued on a timely manner. Several pending issues and questions that the SBV and the MOF need to address, have delayed the drafting of the circulars. These issues include:

*a) Restriction in product offerings.* The decree states that only MFOs that have accepted mandatory savings for three years will be allowed to accept voluntary savings as licensed MFIs. Furthermore, a higher level of capital (VND 5 billion) is required for MFIs that accept voluntary savings. Consequently, MFOs that cannot meet the higher capital requirement will not be able to provide this valuable service to their clients nor use these savings as a source of funds.

Several microfinance programs currently offer a microinsurance product in the form of a mutual assistance fund that provides death and health benefits to contributing members. Under the new decree, licensed MFIs will only be able to act as agents for banking and insurance related fields. The key issue here is whether this provision in the decree would limit the ability of MFOs to innovate and design products that are appropriate to the poor.

*b) Ownership of licensed organization.* The decree states that licensed MFIs could receive trusted capital from organizations (foreign and domestic) and individuals. However, the role of clients/members and investors in the ownership and governance structure is unclear. One of the central aspects of the Grameen methodology is that clients should have a representative voice in the organization, and several MFOs in Viet Nam, such as the Uong Bi Women Promotion Development Fund, currently have clients on the steering committee or management board.

*c) Taxation.* Current microfinance providers are not subject to tax because of their status as a non-profit or socio-political organization. Under the new law, MFIs will be subject to income tax. The issue deals not only with the level of tax to be levied but also relates to the starting date for implementing these taxes. Since most of the current providers are not making profit, the question that the MOF is currently grappling with is whether a preferential rate would be imposed for an initial period and subsequently raised as the institution matures. In addition, the decree does not make clear whether MFIs could choose to continue to operate on a non-profit basis.

***Challenges specific to microfinance practitioners.*** In focus group discussions held in Ho Chi Minh City and Ha Noi in June 2005, and in written surveys, the following issues were cited as the top concerns of microfinance practitioners:

*a) Organizational structure.* The majority of microfinance programs are being implemented through the VWU, which often oversees several programs funded by different donors and international NGOs. One question is at what level, national or province or district, the MFO would be registered.

*b) Finding and hiring qualified management and staff.* Over half of microfinance practitioners who responded to the written questionnaire ranked this issue as most difficult. Licensed MFIs will have to hire specialized staffs that have appropriate skills and educational background in economics and/or finance. A few programs have recruited staff from outside of the VWU at the district level but not at the commune or village level. The most difficult recruitment will be for leadership and management positions

since the talent pool is limited especially at the provincial level and below. More detailed discussion about human resources is provided in section III.B.1 below.

*c) Minimum legal capital.* For larger and well established microfinance providers such as TYM and CEP, the minimum capital requirement will not be an issue. Smaller programs at the district level however, such as those set up by ActionAid, may be able to meet the VND 500 million requirement but not the VND 5 billion required for mobilization of voluntary savings. Since most of these funds are currently mobilizing voluntary savings, they will not be able to continue unless they decide to consolidate and/or merge their activities with another organization in the same locality, or link up with other Action Aid partners. There are also several microfinance programs set up at the commune level who will have a hard time meeting the VND 500 million requirement. The pending questions for those organizations that do not have enough legal capital are: (a) who owns the capital that the microfinance program has accumulated over the years—the local partner or the international NGO - and (b) how will the capital be reinvested—into another licensed MFI, into another program of the international NGO in the same locality, or into the international NGO’s overall country programming (which means the money will be taken away from the community).

***Challenges specific to State Bank of Viet Nam.*** The SBV Department directly responsible for the drafting of the decree has been making conscious efforts to listen to the concerns voiced by microfinance practitioners in the content of the decree, and to integrate this feedback into the follow-up circulars. Nevertheless, other departments within the SBV and representatives at the local branches of the SBV still do not have sufficient or correct knowledge about microfinance. The three top difficulties cited during focus group discussions and in written surveys were:

*a) Knowledge about basic principles and practices in microfinance.* The key SBV staff involved with Decree 28 had a chance to visit several microfinance programs during the drafting process and have been proactive in soliciting feedback from practitioners and stakeholders regarding the follow-up circulars. However, they feel that they still are not able to grasp the full universe of microfinance models that exist out there. In addition, they still need specific information about loan products and methodologies, accounting and financial management practice, staffing, etc., which will be important elements of the license application review process.

*b) Available staffing and resources.* There seems to be a perception at the SBV that the supervision of microfinance activities is not unlike the oversight of commercial banking activities. While there certainly exist many similarities between the two, experiences in other countries show that different, and oftentimes stricter, standards should be applied to microfinance. Learning about the specificities of microfinance will entail a steep learning curve for the SBV staff. In addition, it is unclear how many staff and which department will be allocated the supervisory responsibilities, but one thing is for certain, those who are assigned these tasks will need substantial training and field visits (domestically and to other countries).

*c) Monitoring, evaluating, and auditing.* Best practices in microfinance accounting recommend the use of International Accounting Standards (IAS) in the preparation of financial statements. While this would make it easier for the SBV to read and understand MFOs’ financial reports, the SBV does not know yet (i) which category of indicators and which ratios are typically used to assess performance in microfinance, or (ii) what the desired level of performance would be for these ratios.

### ***3. Comprehensive Strategy and Policy for Microfinance Sector Development***

Currently, there is no comprehensive strategy or policy that sets out the vision and strategic direction for the microfinance sector in the next ten years. There are several reasons for this. Since microfinance is often still viewed as a humanitarian tool rather than as part of the financial sector, it was not included as a component in the country's financial sector development strategy.

Secondly, there has been a lack of networking among current microfinance providers in Viet Nam. Since most of the providers in microfinance are multi-purpose NGOs, their initial focus was on local community development rather than on developing a national level network of financial institutions serving the poor. As a result, the Vietnamese microfinance market evolved in a fragmented manner with each local microfinance program working in isolation with its own objectives and targets.

In the past five years, however, microfinance practitioners began to see themselves as part of a broader "sector" rather than just individual programs. These organizations started to disseminate more information about their program, including performance information, and to share challenges and lessons learned from their experience in implementing microfinance in Viet Nam. In 2004, a Microfinance Working Group (MFWG) was established to formalize the information sharing process and more importantly, to advocate for the microfinance decree in a unified manner. Currently, the MFWG has an email list serve, holds regular meetings, and publishes a semi-annual microfinance newsletter to disseminate microfinance best practices as well as performance and financial data of microfinance organizations in Viet Nam. This grouping could be seen as an informal but nascent microfinance association.

While the MFWG has effectively forged a common voice for the sector, it could be more proactive in promoting the achievements of the microfinance sector and in highlighting issues facing the sector to policymakers, donors, and other stakeholders. Decree 28 has filled a gap and created a legal framework for microfinance, but as discussed above, pending issues will need to be addressed.

In order to ensure a unified approach for tackling the challenges facing the microfinance sector, a comprehensive strategy or policy for microfinance sector development would need to be developed that has the consensus of all stakeholders and that identifies specific tasks and milestones to be achieved.

### **III. B. Institution Building**

A key principle of microfinance is to build permanent local financial institutions to serve the poor. Among the building blocks of a sustainable MFI are: (a) clear governance and management structure; (b) qualified and motivated staff; (c) efficient systems and procedures; and (d) sound and transparent financial management.

Most of the MFOs have put in place (a) credit policies and procedures in accordance with international best practices, (b) separate accounting systems to keep track of operational costs, (c) fully-dedicated staff to run the microfinance operations; and (d) incentives programs to increase productivity and effectiveness of staff. However, MFOs do not have a clear and autonomous governance structure due to their affiliation with socio-political organizations like the VWU. Currently, most microfinance activities conducted by socio-political organizations are implemented directly by socio-political organizations' staff. Women's Union branches throughout the country are implementing a variety of different microfinance activities.

Licensed MFIs under Decree 28 will be required to have a more delineated management and reporting structure to ensure accountability and quality oversight of the institution. However, in most cases, separate microfinance organizations have not been set up. The role of the Central Women's Union in this process will be crucial. In addition, most of the current MFOs are owned by socio-political organizations that basically belong to the government. The decision on who owns a MFO will be an important institutional challenge.

The following section outlines other significant institutional challenges that MFOs will face in the next five years.

### ***1. Human Resources***

The new decree will help to formalize and professionalize the microfinance sector in Viet Nam. Since the management board, audit committee, and executive directors of the MFI will have to be approved by the SBV, current MFOs will have to ensure that they put in place appropriately qualified staff for these positions. Human resources is considered one of the biggest weaknesses of the sector by practitioners, policymakers, and donors alike. The main issues include:

*a) Staff training.* Only a few microfinance organizations have a standardized training program for incoming staff. These training programs focus on the institution's internal procedures and operations rather than on basic principles and best practices in the sector. Those organizations that are affiliated with an international organization would sometimes benefit from specific technical training; however, these opportunities are provided only occasionally and to a few staff members. Thus, there is a great need for regular, continued formal technical training of staff or management.

*b) Compensation and staff retention.* Many MFOs have difficulty hiring and retaining staff, most often losing their qualified personnel to other international organizations and commercial banks that pay more attractive salaries. Because current programs are usually affiliated with a socio-political organization, they are required to use the salary scale for civil servants rather than develop a scale that would be more in line with financial institutions or the private sector. This issue is particularly relevant at the provincial level and below, since those with a higher educational level would rather work in a major urban center where the pay is more attractive.

*c) Managerial and leadership skills.* Most successful MFIs in the world benefit from a strong and visionary leader who is able to steer the institution towards its objectives. This leader also plays an important role in rallying and motivating staff as well as promoting the institution to potential funders. In Viet Nam, the pool of qualified candidates at the managerial level is quite small and with the passing of Decree 28, the competition to hire a professional manager will be intense. Organizations may have to recruit from the private sector rather than from the NGO sector, though that means having to adjust their compensation level accordingly.

### ***2. Systems, Policies and Procedures***

A viable MFI needs a good information system, strict policies to monitor its activities, and streamlined procedures to ensure efficiency. The key challenges facing the Vietnamese microfinance sector in this area include:

a) *Management Information Systems (MIS)*. The most important weakness is the lack of automation and viable MIS to track and monitor financial as well as portfolio performance. Except for two organizations, CEP and the Viet Nam-Belgium Credit Project (VBCP), the current microfinance lenders either use Excel for their reporting or manually prepare reports.

b) *Portfolio management policies*. Basic policies and procedures to manage and control actual and potential arrears are not in place and not applied uniformly throughout the sector. This issue relates to the calculation and monitoring of the Portfolio at Risk ratio, loan loss provisioning, portfolio aging, and write-offs. While arrears have not been an issue and most MFOs are reporting good repayment performance (average repayment is 98%), systems to monitor and manage portfolio quality should be in place as a precautionary measure, especially since the larger a MFI becomes, the more likely it is to experience arrears.

c) *Interest rate setting*. The majority of MFOs set their interest rate based on what their peers are offering, without considering operational and financing costs, inflationary impact, and capitalization for future growth. VBARD and VBSP receive government funding which enables them to lend out at a lower rate. MFOs feel that they cannot compete effectively if they raise their interest rate. However, MFOs will be unable to become viable institutions if they continue with the current rate. They will have to compete with VBARD and VBSP based on customer service or product differentiation rather than on price.

d) *Savings management*. Nearly all current MFOs take compulsory savings and several are also mobilizing voluntary savings from the public. This is an important source of loan capital for these institutions but is not in line with international best practices, which require that institutions be regulated before being able to intermediate public savings. There is a noticeable lack of information on the savings being managed and on-lent by current MFOs. In addition, most MFOs do not have adequate liquidity management skills and do not have a proper investment policy for the money mobilized from the public. Under the decree, licensed MFIs who plan to mobilize savings would be required to adhere to reporting requirements of the SBV. In addition, MFIs would have to put in place a liquidity management and reserves policy, and pay a deposit insurance fee, to ensure the safety of clients' deposits.

### **3. Financial Management**

The larger MFOs that have specialized staff and those organizations that are affiliated with international NGOs tend to have better financial reports than the others. However, the majority of microfinance programs do not report on their financial situation. Even those that succeed in publishing financial statements may not report on hidden subsidies related to the use of VWU staff and "community volunteers" at the district and commune levels.

The main weaknesses that exist in all MFOs include:

*Accounting and financial analysis skills*. Only a few MFOs are able to produce reliable financial statements due to poor accounting skills among the staff. For those institutions that do have regular financial reports, most do not use them to systematically calculate performance ratios. For projects that submit these ratios to the MFWG newsletter, it is not certain whether the same calculation method is being used, thus making it difficult to compare and evaluate performance. Once the ratios are calculated, it is also unclear if and how the MFO's management is using these ratios.

*Strategic planning and financial projections.* Most MFOs set targets in terms of the number of new clients they want to serve and/or the number of branches they want to open. However these objectives are usually set without financial projections that would enable the institution to gauge its cost and profitability levels in the future. Changes made in the MFO's operations, like credit procedures or product offerings, are not carried out based on actual market research, feasibility studies, and cost analysis.

*Budgeting.* Since most Vietnamese MFOs rely on donor funding for their operations, they prepare budgets and reports based on a specific funding level disbursed by the donor. As a result, the majority of MFOs do not prepare budgets that set out the targeted revenues, investments planned, and targeted levels of expenditure allowed.

### **III. C. Access to Capital**

Currently, MFOs are not allowed to access funding from commercial banks or from foreign investors. Instead, the institutions have had to rely primarily on grant funds and contributions, which severely limits their ability to grow. With the new decree, they will be able to access capital from individuals and organizations inside and outside of Viet Nam, thus providing them with a wider range of funding sources from which they could tap to expand their operations. However, the question here is whether the current level of MFOs' finances and the quality of their reporting will be adequate to meet the documentation requirements of commercial banks. Banks usually like to look at cash flow in their risk analysis yet many MFOs do not or are unable to track and prepare a cash flow statement. It is also unclear whether MFOs' performance is sufficiently transparent and profitable to attract private investors and investment funds.

A key issue relates to potential donor funding available for transformation and adherence to requirements of the decree. Beside the minimum legal capital required, MFOs planning to register with the SBV will need a substantial amount of money to invest in hiring specialized staff, upgrading their existing systems, renting adequate office space, etc. In other countries, organizations such as BancoSol in Bolivia received a substantial amount of donor money in their transformation from a non-profit organization into a formal microfinance institution. Recently, however, donors seem to have shifted the focus of their interventions towards supporting national associations or sector-building activities, rather than on institutional development activities. Since most Vietnamese MFOs will face similar issues during the transformation process, it may be beneficial and more effective for them to channel their request for donor support through a sectoral-level organization such as a national association or a working group.

## IV. RECOMMENDATIONS

While the microfinance sector in Viet Nam has made important strides toward formalization and professionalization, the above discussion has shown that serious challenges and difficulties remain. The following recommendations aim to present some options for policymakers, donors and practitioners to consider in order to keep the microfinance sector on its path toward long-term sustainability.

### IV. A. Enabling Environment

- ***Conduct a comprehensive inventory of the different microfinance schemes in Viet Nam to improve publicly available information about the sector.*** The last major study conducted on the Vietnamese microfinance sector was funded by DFID in 2001. An updated survey is needed of all microfinance providers that would cover formal, semi-formal, and informal players in the financial services sector. It should collect information on the total number of clients being served, total outstanding loan amounts, total amount of savings mobilized, as well as credit methodologies being used, and terms and conditions of credit products. The information would help the SBV and MOF in the drafting of the implementing circulars. It would also serve as the basis of a comprehensive strategy for the development of the microfinance sector in Viet Nam (see below). In the future, the MFWG may consider conducting this inventory on a regular basis (annually or biannually) as a vehicle to track the evolution of the sector.
- ***Review of the government's policy of credit subsidies to the poor.*** A number of studies on financial demand show that subsidized capital usually is not effective in reaching the poor. Subsidized lending creates false expectations and increases the level of dependency among the poor. It generates unhealthy competition in the financial market, making it harder for the poor to get access to loans. Policymakers should reconsider the role of public sector in direct retail of loans to poor households through the VBSP and through socio-political organizations. Instead, the government could assume the role of wholesaler, with low interest loans given to MFIs that are more likely to have better outreach to the right targeted groups.
- ***Technical assistance to the SBV and MOF on implementation of Decree 28.*** Training should be provided on microfinance principles and best practices for all SBV and MOF staff that will be directly involved in the drafting of the circulars and eventual supervision of registered MFI. This is especially important for provincial level staff at SBV branches since they have received little information and direct exposure to microfinance. Technical assistance would include field visits within the country with the purpose of information and feedback gathering, and internationally to learn about other countries' central banks experience with microfinance regulation. Former and/or current regulators and supervisors from countries with a more mature microfinance industry could also be used as technical advisors to the SBV and MOF.
- ***Develop national strategy for microfinance.*** For the microfinance sector to evolve in a sound and viable way, it is important for policymakers and practitioners to jointly develop a national and comprehensive strategy. A drafting committee composed of the major stakeholders should be established in the preparation of this strategy. Members should include representatives of the SBV, the MOF, other relevant government ministries, the MFWG, and MFOs. Among issues to be considered in the strategy are:

- *Integration of the microfinance sector into the overall financial system.* Decree 28 will serve to mainstream the microfinance sector and transform it from a semi-formal status to a formal regulated status. The SBV and the MOF are currently working on revising the regulations related to non-bank financial institutions (i.e. leasing companies, insurance companies, etc.). In many countries, MFOs would be considered as Non Banking Financial Institutions (NBFIs), which is a reason why it is necessary to make sure that there is no apparent or potential contradiction in the regulations governing NBFIs and MFOs.
- *Promoting a competitive and transparent market for microfinance.* Another issue that the strategy should address is the elimination or reduction of distortions in the market such as the use of subsidized interest rates by the VBSP and other government-supported programs. The strategy should explore potential options for government funding of microfinance schemes based on international models and practices.
- *Enabling the participation of a wide range of institutional actors in the market.* The strategy could consider options for encouraging commercial financial institutions to enter the microfinance market, especially in urban areas, where few MFOs operate. In other countries, the microfinance sector usually consists of institutions that do “poverty lending” (i.e. lend to economically active poor households) and those that do “enterprise lending” (i.e. lend to household-based businesses and microenterprises that are growth-oriented and have a potential to create employment). In Viet Nam, MFOs have focused primarily on poverty lending. Hence, the strategy could propose measures for encouraging private commercial institutions to serve the less poor households, household-based enterprises, and microenterprises.

#### **IV. B. Capacity Building for MFIs**

- *Establish a formal training curriculum for microfinance.* As discussed earlier, human resources and the lack of specialized skills is one of the biggest constraints facing the microfinance sector in Viet Nam. Local infrastructure for credit and financial management training is therefore of great importance.

Targeted beneficiaries of training would be: (a) MFI staff at all levels, and (b) MFI boards of directors. The first step would be to conduct a training needs assessment amongst these beneficiaries. The second step in this process would be to prepare a directory of current training providers in order (a) to gauge their interest in moving into a new market and serving the microfinance sector, and (b) assess their technical ability to serve this sector. The creation of a new training center would be considered only if current providers do not have appropriate expertise, if current providers are unwilling to serve the MFI market, or if quality control over courses is inadequate.

The training providers should be commercially-oriented and ideally, should come from the private sector rather than be under the auspices of the government. Providers should charge fees for the courses, although an initial period of subsidization by a donor may be necessary to ensure that an adequate training infrastructure is put in place. In the Philippines, the government created the People’s Development Trusted Fund to provide resources for MFIs and microenterprises capacity building. This may be an effective vehicle through which the GoVN could invest its resources to boost the development of the microfinance sector.



As a starting point, the sector could take advantage of existing courses developed by CGAP, MicroSave Africa, ILO, and other organizations. Core courses for “certification” of microfinance staff could consist of:

- Basic accounting
- Basic credit/loan methodology, client selection and analysis, arrears management
- Internal auditing and internal controls
- Financial analysis
- Market research and new product development.

#### IV. C. Association Building

- ***Transformation of the Microfinance Working Group into a formal professional association.*** Nearly all countries with a thriving and expanding microfinance sector possess a national association, a member-based organization that provides services to MFOs and acts as the representative voice for the sector. Associations often use membership requirements as a method to separate “serious” MFOs aiming to become financially viable from other microfinance “programs” with unsustainable models and goals.

Key roles of the association would include:

- ***Performance monitoring and benchmarking.*** The association would encourage MFOs to adopt common performance indicators and common calculation methods, coordinate regular reporting and publication of performance data, monitor and provide feedback to individual MFOs regarding their performance, and benchmarking performance according to peer groups.
- ***Facilitate training and technical assistance to members.*** Most associations are not direct providers of training but act as facilitator to match up the demand and supply side of the market. Facilitating activities include the development of a training directory and a consultant database.
- ***Coordinate funding opportunities:*** The association would coordinate donor funding and channel capital to qualified member MFOs. The association could also act as a guarantor for individual MFOs to access capital from a commercial lender or donor. The association could possibly become an APEX financing institution.
- ***Advocacy and awareness-raising.*** The association would play the role of promoter for the sector not just inside the country but also internationally. For example, the association could facilitate the posting of sector-wide information on the MIX website.<sup>27</sup> A very important role for the association is to advocate for a favorable legal and regulatory framework before policymakers and the relevant ministries.
- ***Research and development.*** The association would coordinate the publication of newsletters and/or research documents on specific technical issues relevant to the sector, e.g. best practices in savings management, or designing appropriate products for the poor, etc.

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<sup>27</sup> The Microfinance Information eXchange (MIX) website provides performance and financial data about MFIs from all over the world in an effort to promote transparency in the sector and to link up microfinance providers with potential funders and investors.

Since the establishment of the MFWG, the level of networking and information sharing among MFOs has improved substantially. The email list serve has also enabled the dissemination of information about the Vietnamese microfinance sector internationally. More importantly, the Group played a much-needed advocacy role for the passing of the microfinance decree. Formalization of the MFWG into a national association seems to be a logical next step in its institutional development. The national association could set up a Secretariat and appoint an Executive Director who would assume the different activities that are being performed on a voluntary basis by the staff of different MFOs. This would ensure that the association is carrying out its duties and responsibilities to its members and liberate the MFI staff to dedicate time to their microfinance operations. Having a national association would provide a useful reference point and a central depository of information on the country's microfinance sector for potential donors and investors, policymakers, and those who are interested in supporting the sector.

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## ANNEX 2. 11 KEY MICROFINANCE PRINCIPLES

CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor, referred to as microfinance. These principles were developed and endorsed by CGAP and its 28 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

1. **Poor people need a variety of financial services, not just loans.** Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.
2. **Microfinance is a powerful tool to fight poverty.** When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.
3. **Microfinance means building financial systems that serve the poor.** In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector—a “development” activity that donors, governments, or social investors might care about, but not as part of the country’s mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector.
4. **Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.** Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.
5. **Microfinance is about building permanent local financial institutions.** Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.
6. **Microcredit is not always the answer. Microcredit is not the best tool for everyone or every situation.** Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.
7. **Interest rate ceilings hurt poor people by making it harder for them to get credit.** 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. Their growth will be limited by the scarce and uncertain supply soft money

from donors or governments. When governments regulate interest rates, they usually set them at levels so low that microcredit cannot cover its costs, so such regulation should be avoided. At the same time, a microlender should not use high interest rates to make borrowers cover the cost of its own inefficiency.

8. **The role of government is to enable financial services, not to provide them directly.** National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.
9. **Donor funds should complement private capital, not compete with it.** Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor's support is no longer needed.
10. **The key bottleneck is the shortage of strong institutions and managers.** Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.
11. **Microfinance works best when it measures—and discloses—its performance.** Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.

### ANNEX 3. COMPARATIVE ANALYSIS OF CEP, ACLEDA AND CARD

December 31, 2003

	CEP Viet Nam	ACLEDA Cambodia	CARD Bank Philippines
Exchange Rate used for Conversion	5,146.925 VND/USD		55.249 PHP/USD
Date of establishment	1992	1993	
<b>Financial Structure</b>			
Gross Loan Portfolio (in USD)	5,261,957	39,391,301	6,187,532
Total Assets (in USD)	5,962,215	48,240,471	7,709,295
Savings (in USD)	223,861	13,160,685	2,764,449
Total Equity (in USD)	2,991,990	24,657,689	1,235,225
<b>Asset Quality</b>			
Portfolio at Risk > 30 days Ratio (%)	1.38%	0.59%	1.50%
Loan Loss Reserve Ratio (%)	0.38%	1.69%	3.33%
Write Off Ratio (%)	0.17%	1.16%	0.00%
<b>Financial Performance</b>			
Return on Assets (%)	9.20%	4.93%	1.45%
Return on Equity (%)	17.66%	9.30%	10.11%
Operational Self-Sufficiency (%)	169.22%	127.32%	105.97%
Profit Margin (%)	40.90%	21.46%	5.63%
<b>Efficiency and Productivity</b>			
Borrowers per Staff member	324	77	155
Savers per Staff member	363	27	88
Operating Expense / Loan Portfolio (%)	8.45%	23.07%	32.49%
Cost per Borrower (in USD)	10.3	84.2	64.6

Sources: Microfinance Information eXchange (MIX) website









