The nature of NGO microfinance in Vietnam and stakeholders' perceptions of effectiveness

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Abstract
The microfinance industry in Vietnam, particularly those sponsored by non-government organisations (NGOs), has experienced rapid expansion in recent years. While there have been anecdotal reports alluding to their contribution in alleviating poverty, a systematic analysis of this issue has been lacking. In a bid to help address this shortcoming, this paper reports on data that was obtained during a survey and interview process that incorporated various stakeholders including financial donors, NGO-sponsored microfinance institutions (NMPs), village leaders and NMP members and non-members. Firstly, the nature of NMPs is described - their objectives, target groups and the financial products they offer. Secondly, perceptions of NMPs effectiveness are discussed from the standpoint of various stakeholders. NMPs are found to be at a critical juncture. While their activities are widely perceived to contribute to poverty alleviation, their future viability is clouded by donor requirements that they become financially self-sufficient. At the same time, certain government policies make achieving this goal very difficult.

Key words – Microfinance, NGO, Vietnam, perceptions, effectiveness

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1 INTRODUCTION

The microfinance industry in Vietnam has been growing rapidly. In particular, the number of non-government organisation (NGO)-sponsored microfinance programs (NMPs) has grown from a mere handful in the early 1990s to currently more than 60 (BWTP, 2005). There is a widely held belief that this expansion has contributed to poverty reduction. For example, comprehensive surveys such as the Vietnam Living Standard Survey (VLSS) show that as the percentage of rural population with access to rural finance programs (i.e., microfinance and others) increased from 23 percent in 1993 to 40 percent in 1998, the poverty rate dropped from 58 percent to 37 percent (GSO, 1994; 2000). However, beyond this largely anecdotal evidence, what has been distinctly lacking is a systematic analysis of the nature and effectiveness of microfinance.

Since 2003, the authors have been involved in a research program that has sought to address these shortcomings. In early 2004, a survey and interview process was conducted in order to collect additional primary data and included various stakeholders such as financial donors, NMPs, village leaders and NMP members and non-members[1]. The survey and interview process had two main purposes – a. to gain an understanding of the current nature of microfinance in Vietnam such as the objectives of NMPs, their target groups, the financial products they offer, etc, and b. collect both qualitative and quantitative data that would allow conclusions to be drawn on the efficiency of NMPs (i.e., their ability to convert inputs such as labour and capital into outputs such as financial products) and the effectiveness of their operations (i.e., the impact their financial products have on achieving objectives such as alleviating poverty). This paper reports on and discusses a subset of the data that was obtained. Section 2 provides a brief descriptive overview of rural finance in Vietnam. Section 3 briefly outlines the survey process and elaborates on the findings with respect to the nature of NMP operations. Section 4 draws out two key themes from the survey and interview process that relate to

[1] Translated copies of the surveys administered are available from the authors on request.

matters of effectiveness from the perspectives of various stakeholders. Section 5 contains concluding comments.

Much of the discussion regarding NMP effectiveness in this paper is based on data that is qualitative in nature and relates to perceptions of effectiveness rather than what might be termed actual effectiveness. At least in economic research, such data is often looked upon as being the poor cousin of quantitative data and analysis techniques. We respond in several ways. Firstly, there is nothing in the nature of qualitative and quantitative data that make them competing. Ideally, both should be used and research evidence is at its most convincing when both qualitative and quantitative data point in the same direction. Further research drawing on the survey data is planned and will take on a more quantitative orientation. Secondly, notions of inclusiveness and participatory practice in development projects demand that perceptions be given weight in their own right. This is not simply out of deference to some ethical imperative. Integrating perceptions serves a pragmatic end as it is often perceptions that dictate what is and what is not possible and hence actual outcomes. As will later be discussed, this is certainly the case with respect to microfinance in Vietnam. Thirdly, the quantitative analysis of efficiency and effectiveness in microfinance is sometimes problematic. Efficiency analysis is typically based around the specification of a production function that relates inputs to outputs. Yet, in the context of microfinance, it is not even clear what the inputs and outputs should be - savings deposits, for example, could rightly be regarded as both an input and an output. Similarly, deciphering the effectiveness of microfinance programs in tackling poverty (which itself is not amendable to easy measurement) requires the collection of data on an array of control variables since the services provided by NMPs are usually part of a much broader poverty alleviation strategy. Each data series in the array will be costly to obtain and subject to a degree of measurement error. Quite simply, if a researcher wishes to know the effectiveness of microfinance, one of the best means available is simply to ask the various stakeholders for their perceptions.

2 OVERVIEW OF RURAL FINANCE IN VIETNAM

Before the start of the economic reform policy (*doi moi*) in 1986, the formal rural financial sector in Vietnam comprised mainly of traditional credit cooperatives, which were considered representatives of the State Bank of Vietnam (SBV). The first wave of financial sector reform came in 1988 (BWTP, 2005). A key new player to emerge was the Vietnam Bank for Agriculture and Rural Development (VBARD), which was established in 1990 as a policy bank charged with dispensing subsidised credit from the SBV to the rural poor. In 1995, VBARD began transforming itself into a commercial bank. At that time, the Vietnam Bank for the Poor (VBP) was established to take over the reigns of delivering subsidised credit for poverty alleviation. The VLSS 2002 revealed that the VBP accounted for 58.26 percent of the total outstanding loans to poor, rural households (Table 1). In 2003, the VBP was reformed as the Vietnam Bank for Social Policies (VBSP) and began to expand further on its branch network as well as target additional groups such as poor students and disabled and migration workers. A distinguishing operational characteristic of the VBSP is that it has a negative spread between the subsidised interest rate it charges on loans and the interest rate it pays to depositors. To cover its policy lending activities, VBSP receives annual transfers from the national government budget and operates as a non-profit entity (BWTP, 2005).

After suffering from a financial collapse in the late 1980s, traditional credit cooperatives were reborn in the form of rural shareholding banks (RSHBs) or People's Cooperative Funds (PCFs). While the number of RSHBs reached 44 by 1995, that number fell to 19 by 2001 and they now play only a marginal role (UNDP, 1996; Llanto, 2000; BWTP, 2005). PCFs were established on the model of the *Caisse Populaire* system in Quebec, Canada (Hung, 1998). They operate under Vietnam's cooperative law and only provide loans for members, although savings are mobilised from both members and non-members. As of November 2004, there were 901 PCFs in operation. In 2003, this formal financial sector (VBP, VBARD, PCFs) represented over 90 percent of the outreach of rural financial services in Vietnam (BWTP, 2005). Apart from the above institutions, there are government-related institutions such as the TYM fund established in 1993 by the Women's Union of Soc Son district in Hanoi and the CEP fund established in 1992 by the Labour Confederation of Ho Chi Minh City. The main difference between these funds and banks such as VBP is that they do not receive funds directly from the government. Rather, in similar vein to NMPs, their donors include international organisations such as AusAID and the Grameen Trust. Their government connections (such as through the Women's Union and the Labour Confederation) however do provide them with a network that vastly exceeds that of an average NMP. The latest data shows that the CEP fund has reached 50,000 clients (BWTP, 2005) and the TYM fund serves nearly 19,000 members (Tran and Yun, 2004).

In addition to the above government-owned and related institutions, NMPs began to merge in the early 1990s. It is these institutions that are the focus of this paper. Domestic NGO-sponsored programs are few largely because a declaration of separateness from government is still an awkward concept in contemporary Vietnam. NMPs generally function on models derived from overseas experience and can be classified according to three groups, namely Grameen Bank replicas, Village Bank models and Solidarity Group models (Nguyen, 2004). The Grameen Bank model is followed by most NGOs in Vietnam such as Vietnam Plus and Action Aid as well as government-related institutions such as the TYM and CEP funds. In this model, microfinance members establish themselves in groups of five with no family or marriage relations and each person acts as a guarantor for other persons in the group to get loans. Group members meet frequently to contribute savings and repay interest and principal by instalments. The second model is the Village Bank model, which was originally devised by the International Community Support Organization (FINCA) in the mid 1980s. The main difference between the Grameen replica and the Village Bank model is that the latter involves members actually holding an ownership share of the institution from its instatement. The NGOs operating this model include Save the Children Japan and World Vision (BWTP, 2005). The third model is the Solidarity Group Model, which was instituted by an American-based NGO, ACCION International. In this model, loans are provided to groups rather than individuals. Members of groups divide the loan equally among themselves. This model has been applied by NGOs such as Save the Children US and Adventist Development and Relief Agency International (ADRA). Apart from the above three models, there is an initiative by the Save the Children US to establish a joint-venture with a private company and a commercial bank to deliver microfinance services on commercial basis. It does not receive any donor subsidy. This venture aims to utilise the hands-on community development experience of NGOs, the fund mobilisation potential of private investors and the labour productivity of commercial banks. Since the venture has only been in operation for about one year, it is too early to gauge its success (Dinh, 2005). Credit extended by institutions such as CEP, TYM and NMPs accounted for around 8 percent of the total to poor, rural households (Table 1).

The rural financial sector in Vietnam also includes an informal sector. Such providers include moneylenders, friends and relatives and rotating savings and credit associations (ROSCAs). Until the mid-1990s, the informal sector was estimated to be the most important source of credit for Vietnamese households, especially in rural areas. According to the results of the VLSS 1992 survey, 73 percent of rural credit was provided by the informal sector (McCarty, 2001a). Although its importance has declined with the expansion of the formal sector described above, according to the VLSS 2002 survey, the informal sector continues to provide 10.71 percent of credit extended to poor, rural households (Table 1). There will always be a niche for informal lenders, particularly as they tend to offer more scope for borrowers to use loans for non-production related purposes.

Table 1. Access of the poor to credit and main providers

Category	Percentage of poor HHs accessed to credit	Providers							
		VBP	VBARD	Other banks	Job Creation Program	PCF	Social organisations (e.g., NGOs)	Private lenders	Relatives and friends
Overall	**32.46**	**57.76**	**23.25**	**1.11**	**3.73**	**2.83**	**7.98**	**4.07**	**6.64**
A- Rural/Urban									
Urban	31.36	53.89	19.02	1.09	4.76	2.70	15.63	3.52	5.88
Rural	32.60	58.26	23.79	1.12	3.60	2.85	7.00	4.14	6.73
B- Household heads									
Male	35.43	58.20	23.81	1.12	3.43	2.63	7.36	4.19	6.77
Female	25.07	56.21	21.29	1.10	4.80	3.52	10.18	3.65	6.15

Source: General Statistics Office (2005)

3 THE NATURE OF NMP MICROFINANCE - SURVEY AND FINDINGS

3.1 The survey

Data for this study comes from two main surveys: an institutional survey and a survey of households. The institutional survey was aimed at NMPs listed in the NGO directory. This directory is maintained by the Vietnam NGO Resource Centre (www.ngocentre.org.vn). NGOs that agreed to participate in the survey and that were based in Hanoi received a questionnaire followed by a face to face interview. Those based outside Hanoi or who had already transferred the program to local partners received a questionnaire by post or email as preferred. Survey responses were received from 44 NMPs operated by 23 NGOs (of which 21 were international NGOs) and were concentrated in the north and the central regions of Vietnam. The focus on these regions was primarily due to time and resource constraints. Nevertheless, given that the majority of NMPs operate in the central and northern regions (McCarty, 2001b), this response affords a reasonable level of confidence that the included sample is representative of the microfinance community in Vietnam.

The household survey was implemented using a stratified sampling design. Initially, 10 NMPs were selected equally from the two regions (five in the north and five in the centre). For each NMP, a list of member villages and non-member villages were defined and a member village was chosen randomly from each list for the 'treatment' group and a non-member village was selected for the 'control' group. To make a proper comparison, the study did not select non-participating villages randomly from the list of all villages that had not received microfinance in the region. Instead, only villages that met eligibility criteria (typically those that were on a government defined list of poor villages) and had not received microfinance services were selected. In each village, households were selected randomly from the list of eligible households. Where a non-member village was not available (i.e., all eligible villages in the area had received the service), an attempt was made to identify eligible households in member villages who had not received the financial services. The household surveys covered 26 villages (of which 17 were member villages) and 471 households (of which 287 were member households). Apart from the survey of households, interviews were conducted with heads of surveyed villages to obtain information on village characteristics and their perceptions relating to microfinance. Village heads are elected by constituents and then approved by the commune people's committee (CPC) to lead the village. Thus, village heads can be categorised as belonging to the local government. Several semi-structured interviews with CPC representatives were also conducted.

In addition to the interviews and surveys described above, group discussions were moderated during two workshops held in Hanoi. The first workshop was held in February 2004 and introduced the research project to stakeholders. It was attended by representatives from the SBV, donors, local and international NGOs and representatives from the Women's Union (WU). The Women's Union is one of five so-called mass organisations in Vietnam (others include the Youth Union, Farmers Union, etc) that act as a bridge between the Community Party of Vietnam (CPV) and society as a whole. It plays an important role in Vietnamese microfinance because the target group of most NMPs is women. Therefore, when a NMP approaches a local government to elicit support for their microfinance program, the WU will usually be assigned as a partnering body. The second workshop was held in May 2004 after the survey and interview process had been undertaken and afforded the opportunity for preliminary findings to be presented and discussed.

3.2 Objectives of NMPs

The NMPs that were surveyed were asked to nominate the main objectives of their schemes and to rank the relative importance of these objectives on a three-point scale (very important, important, and less important). Responses were received from 30 NMPs. All indicated that helping the poor access financial services was one of their main objectives and 29 of the 30 ranked it a very important objective. There was also firm evidence to conclude that most NMPs aspire to achieve financial self-sufficiency (ie., no longer be dependant on donor support), with only 2 of the 30 respondents not considering it a main objective of their scheme. Of the 28 NMPs that did consider it a main objective, 25 described it as being important. The third most common objective reported by 14 of the 30 respondents was to generate a profit. This should not be taken to imply that many NMPs have a commercial rather than development orientation. All of the NMPs that nominated generating a profit as being a main objective described it as being less important and also nominated at least one of the other objectives described above as being another main objective of their scheme. Thus, a more nuanced interpretation is that a sizeable proportion of NMPs view generating a profit as a means of better achieving financial self-sufficiency and helping the poor access financial services. Related to this issue is that a regular point to emerge in interviews was that the longer the NMP had been in operation, the higher the priority that tended to be accorded to achieving financial self-sufficiency and generating a profit. This is explained by the fact that while most donor agencies are prepared to provide start up funds and subsidise the operations of an NMP for a period of time such support is rarely indefinite.

3.3 Target groups and beneficiaries

Responses were received from 44 NMPs in regards to their target groups and beneficiaries. All identified women as being their target group, especially those who were also members of the WU. The priority given to women by NMPs in Vietnam is consistent with international practices (eg. Grameen Bank in Bangladesh). An initially surprising finding was that the institutional survey showed that despite the stated importance accorded to the objective of helping the poor access financial services, on average, only 41.5 percent of microfinance members could be classified as being poor according to the national poverty line. What transpired was that many NMPs preferred to use locally derived measures of poverty to distinguish between the poor and non-poor. One common approach is participatory wealth ranking (PWR) activities, where a selected group of villagers rank all households in the village using a series of indicators such as income, housing condition, household accessories, production equipment, education of children, etc. Sometimes poverty incidence as measured by the national poverty line and the PWR poverty measure differ considerably. For example, an NMP run by the Rural Development Services Centre (RDSC), a Vietnamese NGO to which the first author is affiliated, recorded 60 percent of their members households as being poor using PWR. However, by using the national poverty line only 17 percent would be considered poor. Another possible reason for members being non-poor is that by the time the survey was conducted some had already benefited from program and escaped poverty. Yet another factor that emerged in interviews was that some members, although not considered poor themselves, wished to stay in NMPs to maintain a social network. The poor from ethnic minority groups are on the whole not well represented amongst the ranks of NMP members. In aggregate, members of ethnic minority groups accounted for 29.3 percent of the total members surveyed. This figure may sound impressive given that the percentage of minority groups in the population as a whole is only 13.8 percent (GSO, 2005). However, it is distorted in the sense that it is a mean rather than a median figure. Apart from a couple of larger schemes that focus almost exclusively on ethnic minority groups, the majority have very little dealings with them at all. According to many of the NMPs interviewed, ethnic minority groups, with the exception of the Chinese group, depend mainly on subsistence agriculture and hence the introduction of cash through microfinance services was thought to be of little use to improving their production and livelihood. In an attempt to overcome this problem, some NGOs have introduced in-kind credit or revolving funds of inputs such as seed and animals. Another barrier is that most ethnic minority groups in Vietnam live in remote areas, creating very high transaction costs due to travel difficulties, language barriers, and limited numeracy skills (Che, 2002).

3.4 Financial products

There were only two financial services offered by the NMPs surveyed - credit and savings products. Many NMPs actually described themselves as being Credit and Saving Programs. Other products such as microinsurance and money transfers are rarely available, except in the funds that are connected to the government by virtue of their larger scale and more established networks. For example, the CEP fund provides insurance for health and livestock and the TYM scheme provides death insurance to members and their families. Most of the NMPs interviewed were not enthusiastic about establishing insurance operations. The main reason was because their staff are frugally trained in even basic banking products. Another perceived problem was a lack of insurance product awareness amongst the rural poor in Vietnam that would limit its uptake. The survey also revealed that 79 percent of the credit borrowed by members was for investment purposes. This reflects rules in 69 percent of NMPs that loans are only to be used for production purposes. The most common types of investment from microfinance loans include animal husbandry, crops and off-farm businesses. The proportion of credit extended for on-farm uses was identified by some NMPs as being somewhat incongruent with the microfinance principle of small, regular loan repayments as these types of investment tend to generate seasonal (or longer) fluctuations in income. Of the credit that was extended for consumption purposes, the most common uses were education fees for children, health care and food. All NMPs applied the principle of social collateral rather than physical collateral in their credit service. In the case a borrower defaults, group members are responsible for repaying the loan or face the possibility of being excluded from future loans. Default is also commonly discouraged through the required contribution of compulsory savings, which will be blocked and retained in case of default. Some schemes also invited a representative of local government (e.g., village heads) to the supervision board. Since NMPs are often integrated into other development activities, the local government has an incentive to help NGOs by enforcing intentional defaulters to repay. The design of NMP credit (i.e., small loan sizes and regular instalments) is also held to protect against default.

The saving service provided by NMPs consists of a compulsory and voluntary component. In all NMPs surveyed, the compulsory saving account is not for withdrawal unless members want to quit the programs. The purpose of this compulsory account is three-fold. First, it creates a buffer in case of default as described above. Second, it creates a habit of regular saving practice amongst members. Third, the saving fund helps to build an awareness of ownership amongst the members. The amount of compulsory saving required per member household was found to be relatively little ranging from VND 5,000 to VND 15,000 per month. The average rural income in Vietnam is VND 220,000 per person per month (GSO, 2005). Voluntary savings are designed to mobilise additional resources from the community. Opening a voluntary savings account with a NMP can be a convenient and attractive option. For example, the interest rate paid on savings in the NMPs surveyed was around 0.6 percent per month (Table 2). This compared with 0.25-0.4 percent per month on offer at banks such as VBARD at the time. According to current legislation (to be discussed in more detail later), NMPs are only allowed to mobilise voluntary savings from their members.

Table 2. Descriptive data from NMPs surveyed

	Units	Mean	Median	Minimum	Maximum
Number of members	Persons	2382	800	68	19508
Number of borrowers	Persons	2231	691	48	19608
Average loan size	'000 VND	988	787	318	4471
Loan interest rate	Percent/month	1.28	1.20	0.80	1.70
Loan term	Months	14	12	6	36
Number of savers	Persons	2045	631	0.00	19508
Average saving amount	'000 VND	220	149	10	1000
Saving interest rate	Percent/month	0.60	0.60	0.40	0.85

4 STAKEHOLDERS' PERCEPTIONS OF EFFECTIVENESS

In this section we report perceptions surrounding the effectiveness of microfinance from the perspective of various stakeholders including village leaders, donors, NMPs, members and non-members. In order to make the commentary tractable, two basic themes have been drawn from the survey responses and interviews conducted.

4.1 Microfinance programs were perceived by members and village leaders as being effective in alleviating poverty

When members of NMPs were asked what their expectations were when they joined, 95 percent stated that they had expected participation would increase their incomes. When subsequently asked whether their expectation had been fulfilled to date, 99.3 percent reported that it had.

Follow-up questions were asked in a bid to determine what exactly it was about the services provided by NMPs that had led to this positive perception. The most common response was simply that NMPs provided them with access to financial services, particularly credit. Members reported a vital need for credit as the nature of their rural production meant that incomes fluctuated according to season. Members were also asked what they would have done if they had been unable to access a loan from a NMP. A significant proportion (35 percent) said they would have foregone the investment. To the extent that investment is a key determinant of future incomes, the perception that access to credit had improved their incomes is justifiable. It was also interesting to note that 45 percent of members said that had they not been able to borrow from NMPs they would have resorted to borrowing from moneylenders. This is despite the fact that the interest rate charged by moneylenders is usually three to five times that charged by NMPs (McCarthy, 2001a). This willingness to borrow at higher interest rates implies that many would-be borrowers do have access to high return projects. Non-members also reported a positive disposition towards the services provided by NMPs. When asked if they would be interested in joining a microfinance program if one was available in their area and if they were deemed eligible, 99 percent said they would be. The most common reason given for their interest was to gain access to credit services. One caveat that needs to be made clear when reporting the positive perceptions associated with the services offered by NMPs is that the interest rate they charged on loans is in most cases a subsidised rate. The interest rate charged by government-owned banks such as VBP is subsidised even more heavily. This issue will be discussed in more detail later but suffice to say here that the extension of cheap credit will expectedly promote positive perceptions and lead to robust demand.

In regards to the positive features associated with the services provided by NMPs, other common responses were a) 70.1 percent said they liked the simple and quick loan application procedure, and b) 65.1 percent said they liked the flexibility in loan repayments. The average time borrowers reported having to wait for a loan approval was only a couple of days and the paperwork consisted of a one-page loan application form. There were no physical collateral requirements and borrowers typically repaid loans in small monthly instalments. In contrast, at least until recently, the standard loan from VBARD required physical collateral, was for a period of three years and required the lump sum repayment of interest and principal. Aside from providing increased access to financial services, one of the chief justifications undergirding the microfinance movement worldwide is that NMPs are better able to serve the poor because they are more flexible and innovative than formal banking institutions. The responses we received lend support this assertion.

The perceptions of village leaders were also sought regarding the effectiveness of financial services (including but not limited to microfinance). Village leaders were asked to nominate the relative priority areas for alleviating poverty in their communities. Notable was the fact that financial services, alongside infrastructure, ranked as being the most important priority areas. These two areas ranked ahead of other expectedly worthy areas such as health care and education (see Table 3). The penchant of village leaders for increased access to financial services can also be at least partly explained by the widespread practice of interest rate subsidisation. In this way the practice may be said to distort the priorities of village heads in favour of financial services vis-a-vis areas such as education and health care. The fondness of village leaders for financial services and infrastructure might also be explained by the fact that additional resources in these areas result in outputs that are more immediate and visible than spending in education and health care.

Table 3. What are the relative priority areas to alleviate poverty in your community?

Factors	Ranking (percent)		
	Average priority	High priority	Very high priority
Financial services (loans, credit, savings)	3.8	57.7	38.5
Infrastructure (roads, electricity, irrigation)	3.8	50.0	46.2
Health care	38.5	61.5	0.0
Education	38.5	57.7	3.8
Production services (agricultural extension, job training, processing)	47.8	47.8	4.3

4.2 Microfinance institutions perceived that government policies would largely determine their ability to exert a positive impact over the medium and long term

When NMPs were asked open-ended questions regarding what they considered to be the main factors promoting and hindering their operations in Vietnam, the role played by the government came up prominently in both instances. On a positive note, it was said that it was not uncommon for the local government to provide operational support. This support often came in the form of an in-kind staffing subsidy through the WU. In addition, the local government also sometimes provided free (or heavily subsidised) office space. One NMP also reported that best practice in microfinance had been promoted through the official media.

On a more negative note, two issues stood out. Firstly, 93 percent of NMPs raised the official policy of government-owned banks extending subsidised credit. This point turned out to be closely related to the fact that when NMP members were asked what they disliked about the services NMPs offered, 51 percent responded that the interest rate they levied on loans was too high. Interviews with NMPs revealed the problem was primarily that members made judgements regarding the suitability of the interest rate by comparing it with the rate charged by government-owned banks. At the time of the interviews, for example, the VBP was charging 0.7-0.8 percent per month whilst the typical NMP charged around 1.2 percent per month (Table 2). The rate charged by NMPs was on a par with that charged by VBARD. What is important to note is that NMPs reported to being effectively duty bound not to charge in excess of this rate since to do so would be to invite claims of exploiting the poor. NMPs contended that their members were largely unaware that the interest rate charged by banks such as VBP was a subsidised one. Lenhart (2000) has claimed that the interest rate offered by the VBP at the time was around half that which would be consistent with cost recovery. Along similar lines, some NMPs stated that their members felt they were obligated to provide lower rates of interest since they were billed as development programs.

The implication here is that as long as government-owned banks offer subsidised interest rates, it can be expected that NMP members will express dissatisfaction regarding the interest rate charged by NMPs. This perception presents a serious conundrum for NMPs in Vietnam. While members report to benefiting from the programs in place, if the official policy of interest rate subsidisation is maintained NMPs will be limited in their ability to charge an interest rate that would be consistent with financial self-sufficiency. And as was noted earlier, while donor organisations typically accept responsibility for subsidising operations during the initial set-up period, over time they expect the programs will become self-sufficient.

The second major hindrance – raised by 82 percent of respondent NMPs – was related to the regulatory framework surrounding NMPs. At the time the surveys and interviews were conducted, NMPs were operating without any supporting legislation that defined and protected their operations. Some also complained that government policies relating to matters such as labour recruitment and taxation requirements were unclear. In this respect, one might expect that the decree released in March 2005 on the organisation and operation of microfinance institutions in Vietnam would be welcome. And in many ways it was. For the first time, NMPs had a formal document that defined the types of financial services they were permitted to engage in and were given legal protection covering their operations. However, while it is still too early to confidently predict the long run impact of this legislation, there are some worrying issues. The decree by the SBV sets out minimum legal capital requirements for NMPs. For those that do not accept voluntary deposits, the minimum legal capital requirement is VND 500 million (≈$US 32,000). For those that do, the requirement jumps to VND 5 billion (≈$US 320,000) report (ADB, 2003) for the Asian Development Bank (ADB) and the SBV on the regulatory framework surrounding microfinance institutions in Vietnam, Price Waterhouse Coopers wrote that the typical range for microfinance institutions internationally was between $US 60,000 - $US 100,000. Data from our survey showed that only 32 percent of NMPs had start-up capital of more than VND 500 million and no NMP had VND 5 billion. According to the decree, NMPs that do not satisfy these minimum requirements within two years, will be required to stop their microfinance activities.

Aside from the interest rate being considered too high, the next most common criticism of NMPs, which was raised by 42 percent of member respondents, was that the loan size on offer was too small. From the perspective of the NMP, smaller loans served several beneficial ends. Firstly, they helped to screen the rich out from accessing to microfinance. Having physical collateral, the rich would often prefer to access credit through one of the banks such as VBARD rather than incur the opportunity costs that relate to borrowing money from an NMP (regular meetings, etc). Secondly, it was considered a training process for the poor to manage their loans. Thirdly, the small loan size allowed the NMP to reach more clients. The latter is a practical consideration forced upon NMPs already heavily reliant on donors for loanable funds. The ratio between local funds (ie. from member savings) and total loanable funds amongst the NMPs surveyed was on average just 19.3 percent. There were only three programs in the sample that had a ratio of more than 50 percent. From a poverty reduction standpoint, this constraint is worrying since the small average loan size and ensuing complaints imply that some potentially productive projects are going unfunded due to the lumpy, indivisible nature of investment (McKinnon, 1973). While there may well be an economic justification for concluding that NMPs should offer larger loans, there is clearly an interplay between this issue and the government policies raised above. It is hard to see how NMPs will be able to attract the additional funds they need to be able to offer larger loans when they are hamstrung with respect to the interest rates they charge (because of the subsidised interest rate in government-owned banks) and in accepting voluntary deposits from members and non-members (by legislation restricting their services to members and imposing high minimum legal capital requirements).

5 CONCLUSIONS

NMPs in Vietnam are now at a critical juncture. Somewhat ironically, the question marks over their future are in spite of their own continued professed dedication to helping the poor and the perception of members, non-members and village leaders that their operations do contribute to poverty alleviation. Now that many institutions are at least several years old, sponsoring donors are increasingly expecting them to become financially self-sufficient. At the same time government policies such as subsidising official interest rates and instituting high minimum legal capital requirements make it very difficult for these institutions to attract a volume of savings that would be consistent with financial self-sufficiency. A constricted savings volume also contributes to the situation whereby NMPs are forced to choose between offering smaller loans to a greater number of members or larger loans to fewer members.

If these issues remain unaddressed, two scenarios are likely to eventuate – neither of which is appealing from the perspective of helping the poor. The first is that donors will pull the plug on programs that fail to reach financial self-sufficiency or they will be forced to close by the government for failing to reach minimum capital requirements. The second is that current NMPs will switch from their current development orientation to more commercial objectives in order to survive – they will, in effect, cease to be microfinance institutions that focus on poverty alleviation. If financial markets in developing countries were complete and not subject to market failure, a distinction need not be drawn between development and commercial objectives. In reality however, many market failures do exist and there are often large divergences between the financial and social returns to lending (Kane, 1983). Both of the above scenarios would be extremely unfortunate given that nearly 70 percent of poor rural households in Vietnam still do not have access to vital credit services (Table 1).

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