# NGO MICROFINANCE IN VIETNAM: STAKEHOLDERS' PERCEPTIONS OF 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). Taken together, they now account for more than 15% of credit extended in urban areas and 7% in rural areas (GSO 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; GSO 2000). However, beyond such general trends in aggregate data, what has been distinctly lacking is a systematic analysis of the nature of NMPs (i.e., their objectives, target groups, types of financial products on offer, etc), 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 NMPs (i.e., the impact their financial products have on achieving objectives such as alleviating poverty).

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]. This

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

paper reports on a subset of the data that was collected which relates to stakeholder perceptions of effectiveness. Section 2 outlines the data collection process. Section 3 draws out two key effectiveness themes from the survey and interview process. Section 4 contains concluding comments.

Before moving on to the main body of the paper, we feel it is important to justify why it is that much of the effectiveness discussion 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 that includes agricultural extension programs and the like. 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 DATA COLLECTION

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 46 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 2001), 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 State Bank of Vietnam (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 that act as a bridge between the Communist 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 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.

### *3.1 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 (McCarty 2001). 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 Vietnam Bank for the Poor (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 Vietnam Bank for Agriculture and Rural Development (VBARD) (the major state-owned, commercial bank in rural areas) 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 1). 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-à-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 1: 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, 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 |

### *3.2 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. 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 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. When NMPs were asked to describe their main objectives, financial self-sufficiency trailed only “helping the poor access financial services” in terms of importance.

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). Meanwhile, the typical range for microfinance institutions internationally was between $US 60,000 - $US 100,000 (ADB 2003). 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 (e.g. regular meetings). 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).

## 4 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 (GSO 2005).

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