

## Microfinance for the Poor in Viet Nam

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**Abstract:** Most of the research on hunger elimination and poverty reduction in the global scope as well as in Vietnam shows that microfinance is an effective tool which has been successfully applied in many countries for the purpose of fighting against poverty and hunger. In general, the performance of hunger elimination and poverty reduction in Vietnam has gained impressive achievements in accordance with proposed Millennium Development Goals. However, the efficiency of microfinance service for the poor is still inadequate. Together with success in the innovation of legal framework, microfinance market becomes busy but in a muddle, with the principles in which the market is still governed by subsidiary lending mechanism. In addition, Vietnam microfinance system is still at a start in comparison with the regional and international standard. The writer would like to share his opinions and propose some solutions and recommendations in order to support microfinance organizations to stably operate and to help the poor in Vietnam for a long time and in a sustainable manner.

**Key words:** microfinance; financial services; poor people; poverty

**JEL codes:** I390

### 1. Microfinance For Hunger Elimination and Poverty Reduction in Vietnam

#### 1.1 Definition and Classification of Microfinance

According to the World Bank: “Microfinance has evolved as an economic development approach intended to benefit low-income women and men. The term refers to the provision of financial services to low-income clients, including the self-employed. Financial services generally include savings and credit; however, some microfinance organizations also provide insurance and payment services

According to Credit Institutions Law of Vietnam (2010): “Microfinance supplier is a credit agency that mainly supplying some financial banking services to satisfy the demand of low-income households, individuals and very small firms”.

In the Decision No. 2195/QĐ-TTg dated 06/12/2011 Approving the Project of building and developing the microfinance system in Vietnam until 2020” by the Government with the target: Building and developing a safe and sustainable microfinance organization system which is intended to poor people, low-income people, very small enterprises to contribute to the implementation of the Party and State’s policy on ensuring social security and sustainable poverty reduction.

According to the adjustment of legal normative acts issued by the State Bank, microfinance organizations are divided into 3 groups:

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**Table 1 Microfinance Suppliers in Vietnam**

Official	Semi-official	Non-official
<ul style="list-style-type: none"> <li>- Bank for Agriculture and Rural Development of Vietnam</li> <li>- People's Credit Funds</li> <li>- Vietnam Bank for Social Policies</li> <li>- Vietnam Postal Savings Services Company (formerly)</li> </ul>	<ul style="list-style-type: none"> <li>- Some international non-government organizations</li> <li>- Microfinance organizations including social funds operating in microfinance.</li> <li>- Hundreds of small projects, programs of credit or microfinance implemented by Vietnam Women's Union and social organizations</li> </ul>	<ul style="list-style-type: none"> <li>- Tonetone - a popular form of savings and capital turnover.</li> <li>- Relatives, friends, neighbors</li> <li>- Creditors</li> </ul>

Source: The author reckons and classifies.

## **1.2 Hunger Elimination and Poverty Reduction Program in Vietnam**

Until the end of 2015, the rate of poor households in Vietnam reduces strongly, to about 4% in the total population. Recognized by the world for being one of the countries getting impressive achievements, Vietnam is an example in hunger elimination and poverty reduction. One of the policies which Vietnam patiently implemented in this activity is developing models of organizations and credits to provide financial services to poor people. In Vietnam, microfinance started in the 1980s; after more than 3 decades of implementation, this is recognized to be an important contribution in the hunger elimination and poverty reduction.

In order to effectively eliminate hunger and reduce poverty, one of the measures appreciated by the Government is strengthening the capacity and ability to integrate of poor people, reducing their vulnerabilities, especially in the sensitive time of the economy such as inflation and economic crisis. For this target, microfinance plays a very important part in strengthening, expanding the approach to finance for rural areas. Microfinance has come to poor and very poor people in the whole country, especially in remote areas where there are no banks.

## **2. Some Recommendations for Policies**

Poverty reduction is a regular and continuous process which needs to recover weaknesses, at the same time determine and resolve difficulties and challenges in the short term as well as in the long term. Measures for poverty reduction should be synchronous and be a harmony combination between the benefits of poor people, community and the country. The measures need to be intended to sustainable poverty reduction on the basis of poor people's taking steps with the support and responsibilities of the community and society.

With the participation of nearly five hundred thousand poor people, with the international help, the creation of conditions of authorities and organizations, Vietnam now has a microfinance providing system with updated technology and in the developing impetus. Through the "Project of building and developing microfinance in Vietnam until 2020" approved by the Government, microfinance today has become much stronger, more diverse and complex; however, new challenges require new measures, including:

### **2.1 The State Establishes the Equality in the Opportunity to Approach Finance**

In the "Report on the development situation on the world in 2006" by the World Bank with the topic of "Equality and development", a concept is proposed including two basic remarkable principles: Equality in opportunities and No deprivation.

This is also the basis for Vietnam to expand the forms so that people, including poor people, people in rural areas, in remote areas, ethnic group people can access finance with a suitable form, which is microfinance. It is necessary to make every effort for poor people not to suffer any disadvantages, but it is also required that poor people should be "equal" to any other people in credit with the principle of "pay your debts".

## **2.2 Managing and Supervising Microfinance**

(1) The system of microfinance management and supervision should be completed to ensure the healthy, safe and effective market activities, to create a strong enough sanction to maintain the activities of microfinance under the law and to protect the participants in the market, and create an equal playing field for economic components to approach the credit capital.

(2) The role of the government is to make microfinance possible but not to intervene directly. The government should establish a policy to encourage financial services for poor people, at the same time to protect the deposit. It is essential to maintain the stability of macroeconomy and to prevent corruption. In special cases where no fund is available, the government allows to sponsor for the healthiness and independence of microfinance organizations.

(3) Measures for microfinance and benefits

The development of microfinance activities for the main purpose of benefits will threaten and create an different nature from the real one of the main task in microfinance which is helping poor people to have better life. When they focus too much on benefits, the new capital flow will concentrate on the areas which can bring about more benefits. That means many poor people and those in remote areas will be omitted. Therefore, the disclosure of interest rate, loan conditions, payment conditions in the whole country is a compulsory measure to make microfinance transparent.

(4) Road map of changing a social policies bank into a commercial bank

A social policies bank is run under the appointment of the Government to serve the politic and social targets of the country. In order that the social policies bank successfully becomes a microfinance retailing bank, this bank's loan interest rate must be enough to pay for expenses of operation to strengthen the capability of mobilizing capital. This needs to be implemented earlier than planned which is 2020 because this will bring benefits not only to the social policies bank and customers but also to microfinance.

(5) Establishing private regulations on interest rate for microfinance

The government should consult and present the National Assembly to have a more broadened regulation on interest rate for microfinance for poor people. This direction will help the government to make a decision on limiting the "fees" which poor people have to add to have credits. In the long term, "a transparent interest rate" is the only way which microfinance organizations apply in the credit contracts with poor people. This is also more appropriate to the limited ability and understanding of poor people. Credit is always the first activity of microfinance organizations to direct to the sustainability and stability.

## **3. Measures for Microfinance Development to Support Sustainable Hunger Elimination and Poverty Reduction**

### **3.1 Microfinance Development as a Connection in the Finance Market**

100% communes approach to services of the social policies bank. However, this does not mean that it is easy for poor people to approach the loan. Although customers of the social policies bank are poor households, students of difficult conditions or exported workers and some other subjects, they have to pass the savings and loan groups' consideration in the following criteria: "Working capacity, health and spirit of business production", then the confirmation of People's Committee that they are poor households before going to the bank.

When passing the above mentioned procedures and a long time of waiting, finally, most of the poor

households can approach soft loans; however, the statistics is not enough, so there are still about over 200,000 near poor households or those who fall back into poverty and are very difficult to approach the loans of banks because of mortgage.

### **3.2 Development from Charity, Subsidization into Continuous Business Activities according to the Market Mechanism**

There are no limit of examples for “lending at an illegally high interest rate” which affects many families as well as many opinions and activities from the authorities to prevent this. However, the objective existence of the supply and demand in lending at an illegally high interest rate should be seen in a multi-directional way and a more suitable way should be found out to resolve it; it can be: instead of prohibiting them, we can establish financial organizations which officially and directly compete with them according to the market law. This is the basis to believe that the goods price (interest rate) will reduce and the services will be better and the beneficiaries are poor people.

Microfinance development is an answer for the continuation of satisfying the financial demand of poor people. There needs a change in the thought that microfinance is a tool of hunger elimination and poverty reduction and should be subsidized, or it is only the movement of organizations which exist popularly and for a long time in many levels, functional agencies and local authorities. Microfinance needs to be considered a long term measure of hunger elimination and poverty reduction; this is a process relating to many periods of loan and many activities to support customers and step by step enhance their living standard.

In order that microfinance organizations exist and develop according to the market mechanism, the first condition of microfinance organizations is to step by step remove “soft interest rate” and change it into “market interest rate” on the basis of correct and full calculation as well as compensation for operation expenses. It is necessary to acknowledge that because the particular of microfinance is small loans, the management expense is high; this makes not many commercial banks focus on this activity when they do not see the benefit from the market of supporting poor people and low-income people.

On the basis of “market interest rate”, microfinance organizations can continue and expand the service in the long term. The sustainable achievement means transaction fee reduction and better services for many customers and new ways to support poor people who cannot approach traditional banks.

### **3.3 Diversifying Goods and Services of Microfinance**

Microfinance organizations have to be lively in satisfying the demand of poor households, so the diversification of microfinance products which is suitable for each condition is necessary in the development. Each new product needs a specific time to test and implement the development periods as well as design according to specific requirements of customers. This process often lasts for quite a long time and the completion needs much effort.

### **3.4 Diversification of Loan Products**

Most of suppliers are more interested in normal loan; they do not care much about the supplementation and adjustment of products and services to be suitable for the demand to satisfy the changes of customers — poor people. Therefore, there are always many tendencies in search for suitable financial services from many different sources which they can approach.

#### **(1) Official Microfinance Organizations**

With the large operation network of Bank for Agriculture and Rural Development and People’s Credit Fund in the localities, most of average income households (sometimes poor people) can approach official financial

services in the locality where they reside. Most products require the mortgage or the holding of land and housing documents. Unsecured loan is seldom accepted; if it is applied, the interest rate will be much higher than that on mortgage. However, according to law on competitiveness of the market economy, loan and savings products are more and more flexible and easier to approach for customers. However, these two financial organizations do not have any clear intention in participating in microfinance market for poor people.

In comparison with Bank for Agriculture and Rural Development and People's Credit Fund, the social policies bank is the most typical microfinance organization; the loans of the social policies bank are generally designed in the whole country, so it is in compliance with regulations, little (and difficult) to change. However, facing with the continuous capital reduction and more in the latter year than that in the former year, in the condition of difficult economic conditions without any signals of recovery, the supplemented budget will be more and more "rare" and difficult to disburse on time. The social policies bank is facing real difficulties to harmonize the social and economic targets.

The short term measure is that the products of the social policies bank should be divided into two parts according to the model of "electricity price ladder" now of our country. That is apart from the first "soft" capital, if the poor want to borrow more to meet the requirements of business activities, the loan will be calculated according to the "market interest rate". This will be an important foundation before having more suitable measures to ensure the sustainability of the social policies bank in the localities in particular and that of Vietnam in general.

#### (2) Semi-official Microfinance Organizations

For young microfinance organizations, the first stage is very difficult to provide many types of different products to customers; the first basic products are often credit and savings. The purposes of loans of the poor are very diverse, including: production, small business, repairing/building houses, biogas installation, buying household devices and contacting means... The loan period is from 3 to 24 months, payment is performed weekly or monthly on the day of group meeting or periodically; the amount of loans is from 500 thousand to 30 million dong. However, the average loan is about 3 million VND with the interest rate from 1% to 2%/month.

The adjustment and correction of current products to be more suitable for the demand of each poor household group are a realistic way. The diversification of loan products and multi-choice provision in payment period, loan period and loan amount can be applied quickly in the system. The biggest challenge is reducing the expenses to create more competitive and effective products and services.

Microfinance organizations should not only care about the development of products to satisfy the demand of customers but also go ahead, create the demand of customers for new products to improve their welfare such as insurance, encouragement for using biogas in cooking.

#### (3) Loan Interest Rate

Microfinance provides a small capital amount with a convenient transaction with helps customers to easily manage and pay the debts, but the expense for this is often quite high. Setting a suitable interest rate is an important problem for the sustainability of microfinance organizations as well as the maintenance of continuation of capital for the poor.

The current interest rate of microfinance is about 1-2%/month, higher than the loan of commercial banks. This interest rate often attracts the attention as well as is compared with "soft" interest rate of the social policies bank, so it is often criticized because it is often considered that this interest rate is beyond the poor's capacity, which is not "humanitarian". However, if compared with the world microfinance, the average interest rate of Vietnam microfinance is much lower. For example, the interest rate of microfinance in India is about 25%/year

and in Philippines is about 30%/year although these countries normally have lower inflation compared with Vietnam.

The poor are both buyer and seller, so they understand the expenses to have the microfinance service shipped to their home. Time losing, job postpone and travelling expense with increasing petrol price... to have a small loan in banks can be quickly calculated in cash by themselves. Therefore, the interest rate of microfinance organizations is a little higher but it is more convenient and its procedure is simpler and easier to understand with careful consultancy; that makes the poor accept. In addition, the poor find their “position” of customers when being served but not have to wait to “apply for loan” as in the bank transaction offices. Obviously, one of the important references is that the interest rate of microfinance is much lower than that of “illegal credit” in an area as well as there is no “debt tightening” when poor people are customers of microfinance organizations. The interest, closeness and good customer service before and after the financial service provision to the poor make a difference between microfinance organizations of the social policies bank.

Besides, one more feature which also needs to be considered is that: In rural areas, the ability of balancing the on-site capital of credit organizations is generally limited. The average on-site mobilized capital of credit organizations only satisfies about 30% the loan debit in the locality, the rest must be transferred from urban areas or borrowed from other organizations. Moreover, the difficult traffic condition and far distance of poor households make the interest rate in rural areas higher than that in urban areas.

### **3.5 Diversification of Savings Products**

#### **(1) Savings for Microfinance Organizations**

Microfinance demonstrates that the poor can save if having suitable mechanism. The method of savings of microfinance is designed for the purpose of helping the poor to create their properties from a small built-up amount to have larger amount to invest in business production or risk prevention. The deposit mechanism does not limit the amount although it is only 5,000 or 10,000 dong; but they have to regularly and periodically deposit to create the awareness and habit as well as effort to implement. Interest of the deposit amount is paid appropriately to encourage the sender, and this is also an important foundation to create the trust for borrowers with a much higher interest rate compared with that in savings.

Savings is an important capital for microfinance organization. There are many ways to mobilize the savings as well as many forms to save money such as: compulsory savings, normal savings and according to each type of customers. The encouragement of compulsory savings should be carried out with a small amount and flexible time with the target of keeping money for the poor, even for those not participating in loans of microfinance organizations.

However, it is essential to pay attention to the fact that the expense for normal savings mobilization is very high because the expense for operation and management of this capital and the interest payment from 3% to 7%/year. The savings mobilization is a big challenge but a necessary step. The savings mobilization help increase the complexity in management, the workload and expenses for microfinance organizations, but the result brought about is the independence of organizations from sponsors.

#### **(2) Savings for the Poor**

The supply of and demand for savings products now are standardized with the competitiveness in attracting savings deposit of many financial banking organizations. The banks provide savings products with the lowest deposit balance of 50,000 dong; however, this balance is often 100,000 dong. A savings book can be used as a mortgage in the bank that the customer deposits.

However, most of the banks do still not provide accounts with lower savings amount for poor households and people have to travel to the transaction places and wait, which wastes their time and increases the expense for sender. Therefore, they do not attract the poor with each small amount of savings continuously.

Like any other classes in the society, the poor really want to save money and they need to save to survive and overcome the poverty as well as difficulties in life. When everyone can choose between savings and loan, savings is more preferred. But it is a pity that official financial institutions do not care about this market because they still focus on benefits.

### **3.6 Development of Micro-insurance**

Microfinance organizations should approach micro-insurance as a part in the package of measures for the poor to overcome poverty; this product needs to be considered to gradually replace traditional support. Micro-insurance does not stop in the ability of approaching a small community but according to experience in the world, this form can approach a large number of poor people, thus create a big effect on resolving the poverty in a large scale.

Microfinance organizations should use the micro-insurance model of “partner-agency”, which means they are agencies for permitted insurance companies; become a partner in the “local distribution channel”. Depending on the features of each province/districts, microfinance organizations will coordinate with insurance companies to develop some suitable micro-insurance products such as: breeding, industrial plants, individual accidents, health, longevity, ...

The coordination with insurance companies to design suitable products is the center of the problem. It is not as simple as deducting an insurance product for the middle class — which is very popular — to reduce the expense and serve poor people. For instance, the poor do not care much about insurance for their house but are really interested in the insurance for things creating their family’s income such as breeding poultries and cattle, cultivating.

The demand for protecting from and preventing risks such as: lack of food, diseases, accidents, natural disasters, ... is a permanent demand of people, including poor people. In face of changes of weather, the farmers will have to find ways to diversify their crops. This will reduce their productivity and yield, so insurance is an expense to avoid risks.

Microfinance organizations will contribute to minimize individual risks by combining insurance activities with microfinance services to help the poor to implement “more risky”, longer term investments and thus bring about more benefits, at the same time accumulate experience and have higher income.

Income of the poor often comes from “manual work”, so when anyone in the family is sick, the expense for health and no income (because the main worker is sick or takes care of the sick member) is the most important reason for pushing near poor households to the level of below poverty.

Health insurance is a policy which has a great effect on the poor’s life. Localities should take priority for providing enough nurses, doctors, medical equipment and necessary financial source for medical centers. The hospitals and medical examination rooms have to be strictly followed, inspected and supervised so that no unnecessary medical fees and interventions or other negative events increase the expenses (beyond the health insurance) of the poor.

### **3.7 Expansion of Non-financial Products**

Beside financial services, microfinance organizations need to develop non-financial services as an important part in activities of microfinance such as:

Bên cạnh các dịch vụ tài chính, TCTCVM cần phát triển các dịch vụ phi tài chính như một phần quan trọng trong các hoạt động của TCVM như :

- Vocational training/activities relating to production and technology transfer/ innovation;
- Training basic business skills and finance in the scale of households;
- Providing market information and communication;
- Equipping with knowledge about health care, nutrition, environmental sanitation.

These services are intended to the welfare of the poor, at the same time increase expenses of microfinance organizations. However, the final result will have positive effects of microfinance program on the poor. This shows that the service market for skill development of the poor with many potentials is now still limited.

Health is the most important thing for people, but for the poor, because of many reason, their health care is inadequate although they know that health is their biggest property. The combination of health protection with microfinance activity is practical, so microfinance organizations can approach this problem according to the following directions:

- (i) Program of health care education;
- (ii) Loan provision for medical treatment;
- (iii) Savings encouragement for health care;

(iv) Coordination with hospitals and private medical examination rooms to have continuous connection to provide, consult health problems as well as to find out preference programs, charity towards the poor.

The capital support for the poor is only the initial step (one of the factors of the hunger elimination and poverty production problem). The other important thing is to help them have knowledge to manage their family economy as well as to have business projects by themselves so that they can stand firm on their feet and go further.

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