Growth and Resilience of Savings-based Microfinance Institutions: The Case of the People's Credit Funds in Vietnam[1]

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1. Does the global meltdown affect savings-driven MFIs?

"The $32-billion microfinance sector has been pounded by the worst economic slowdown since the Great Depression," writes Joseph Rosta in the American Banker (1 Sep 2009); "default rates at MFIs are rising… And growth has pulled back significantly, with MFIs hampered by the capital constraints endemic to the financial market meltdown." Statements like this are not based on a random sample of microfinance institutions (MFIs). In fact, many MFIs which make headlines and are found on the *MIX Microfinance Information eXchange* have enjoyed disproportionate support from international investors and donors. MFIs which rely on their own resources – equity, deposits and retained earnings – and do not have a donor paying for their participation at international gatherings are less conspicuous. Paradoxically, least conspicuous are those savings-driven MFIs which occur in numbers too large to be individually listed, such as 4,600 Microbanking Units of Bank Rakyat Indonesia, 1,350 Lembaga Perkreditan Desa in Bali and 1,015 People's Credit Funds in Vietnam, to mention just 7,000 MFIs from three subsets in Southeast Asia. Have they been equally affected by the global meltdown? Does it make a difference if MFIs rely on their own resources rather on those of donors and international investors?

In this paper we present a network of rural credit cooperatives in Vietnam which has evolved since 1993 as part of a globally integrated market economy and examine how its two segments, the rural People's Credit Funds and the Central People's Credit Funds with wholesale and urban retail services have been affected by the global crisis.

Credit cooperatives are a type of microfinance institutions (MFIs) which are, on principle, self-governed and self-financed. This at least is how they emerged in Germany in the mid-1800s (Seibel 2003) and spread from there to numerous countries around the world around the turn of the 19th to the 20th century. In Europe, North America and a few other countries such as South Korea they retained their character as self-help organizations and became part of the formal financial sector. In Communist countries they became part of the command economy and lost their self-help character. In most developing countries they are held in high esteem by the government – so much so that the government has taken their governance into its own hands and generously supplied them with financial resources. This has rarely been to their advantage. In South and South-East Asia, India and Indonesia are two countries where the government with well-meaning interference has undermined the health of a century-old movement, resulting in a lack of services to members and the loss of member savings. There is a dearth of developing countries that could serve as models for the construction or reform of a sustainable self-reliant credit cooperative movement.

Within less then two decades Vietnam, emerging from the collapse of its command economy, succeeded in creating a conducive policy environment, captured some of the lessons of credit cooperative history and build a strong credit cooperative system. Yet, while Vietnam may serve as a model, it would be fatal if the Vietnamese credit cooperative system were simply duplicated. Every country faces the challenge of finding its own way in a given economic, cultural and political environment. In Vietnam, the Government examined the options, benefited from the experience of other countries, but replicated none. Instead it came up with its own innovation: People's Credit Funds (PCFs), self-help organizations under state control, seemingly a contradiction. The case of Vietnam shows that the world of

[1] Source of quantitative data on PCFs and CCF is the State Bank of Vietnam through CCF unless otherwise stated.

cooperatives is more complex than indicated by the simple dichotomy of successful self-help movements vs failing state-supported systems. The newly established PCFs are self-managed and self-financed; yet they are part of a movement in which the State Bank of Vietnam (SBV), the central bank, has been in the driver's seat from the beginning. SBV has been in charge of designing the new system; it prepared its regulatory framework, integrated the network into the formal financial sector, supervised its progress and enforced prudential standards. Yet SBV has abstained from undue direct interference and from using, or abusing, the PCFs as credit channels or for other politically motivated purposes.

The PCF system has mastered several challenges since its establishment in 1993, including the closing of about 100 poorly performing PCFs by the central bank at the conclusion of the pilot phase. It is now facing a new challenge: a test of resilience under conditions of a global financial and economic crisis, which presents a real threat as Vietnam has been increasingly integrated into the world economy in recent years. There are two aspects to this test: the first pertains to the PCFs as local financial institutions with a rural membership of predominantly small savers and borrowers. The second aspect pertains to their apex, the Central People's Credit Fund (CCF), which manages liquidity exchange for the PCFs but in order to make a profit also provides financial services to the general public, including companies and better-off individuals mostly in urban areas. One may expect that the two types of institutions differ in their exposure to the global crisis and perhaps in their resilience.

2. Creating a conducive environment

Since 1976 rural credit cooperatives were part of the command economy of Vietnam.[2] By the mid-1980s, there were about 7,200, covering most of the communes[3]. Their main functions were to collect small deposits and to provide credit to production cooperatives, farm households and small state-owned enterprises (SOEs). (Boi & Hung 1992: 17-19) Yet, the continual decline in the production of rice and other commodities and, finally, a period of hyperinflation led to the collapse of the economy including the credit cooperatives.

The Government responded to the crisis with a new policy, *Doi Moi* ("renovation"), aiming at the introduction of a market economy. Structural reforms were geared to dismantling the extensive system of controls; financial reforms focused on the consolidation of public finances and the reduction of inflation. In 1988 the mono-tier banking system was transformed into a central bank (State Bank of Vietnam, SBV) and four state-owned commercial banks (SOCBs). This was followed in 1989 by a policy of monetary restraint, with a dual focus on credit supply limitations to state enterprises and interest rate increases to positive real terms. Economic reforms included a return to private household farming and a reduction of restrictions on private sector activities. At the same time, Vietnam abandoned its policy of dissociation and entered into economic relations with the convertible area. The impact on output growth and monetary stability was dramatic (IMF 1990: 26; WB 1991: i) – achieved under an American embargo and without significant external support.

The 1989 reforms revealed the weaknesses of the financial system, the four SOCBs being but arms of the SBV, and the SBV failing to carry out its central bank functions. The Government thus moved on to new reforms. In 1990 the Ordinance on Banks, Credit Cooperatives and Finance Companies was passed, providing the legal framework for a differentiated financial infrastructure: SBV as the monetary policymaker and financial regulator, universal banks in government, private and partially foreign ownership, limited-service financial institutions and credit cooperatives. This was followed by a banking decree in 1991, which accorded SBV supervision authority over the banking sector. Subsequently new company, contract, banking and foreign investment laws were enacted. In 1993 a new land law was passed, providing for land use certificates that can be sold, leased, inherited and mortgaged. (IMF 1990: 18-27, 58; Seibel 1992: 48-57; World Bank 1991, 1993)

[2] In the northern part of Vietnam they had been introduced in 1956; some 5,500 existed in 1960.
[3] Local administrative areas comprising three to four villages.

With ups and downs, there has been remarkable growth over the past two decades. Private enterprise is now the backbone of the economy. Out of 12,000 SOEs, around 10,000 have been fully or partially privatized, including one of the SOCBs. Most impressive has been the impact of Vietnam's new agricultural policy. Private land use rights have replaced collective agriculture; and free input purchasing and produce marketing have replaced administrative factor allocations. Harnessing the power of millions of smallholders as private entrepreneurs, the result has been an agricultural miracle, happening almost overnight. In 1989 Vietnam turned from a net importer to an exporter of rice; in 1993 it became the world's third-largest, and in 1996 the second-largest, rice exporter. It is now also a major exporter of coffee and other farm, forest and fisheries produce. Economic performance has been paralleled by social performance. Between 1990 and 2004 the percentage of the population living on $1 or less per day (at purchasing power parity) declined from over 50% to below 10%. Today 94% of households have electricity; almost all children attend primary school; nearly two-thirds stay on to upper secondary level. Free enterprise, free trade and sensible state finances have been the key factors of transformation. Huge problems remain, among them a poor infrastructure, pervasive corruption and, as The Economist (2008: 4, 9) stated, "the glacial speed of legislative and bureaucratic processes".

3. Designing a credit cooperative system

As part of a stated financial sector reform policy, the financial institutions law of 1990 provided a legal framework for the establishment of a rural credit cooperative system.[4] In 1991 a team from SBV and several government agencies was formed to examine the options. Its first decision was to rule out the option of credit cooperatives as local agents of rural shareholding banks or the Vietnam Bank for Agriculture (VBA); as agents they would lack autonomy and responsible management and therefore not evolve into viable institutions. In a second step the team visited the Grameen Bank in Bangladesh, cooperative banks of the Raiffeisen and Schulze-Delitzsch type in Germany and the Caisses Populaires Desjardins, or credit unions, in Canada. This resulted in a dialogue with Développement international Desjardins (DID) and the decision for a pilot project for the period 1993-2000, aided by DID (2008).

To avoid any resemblance to the defunct system which had been cooperative in name but not in nature, a new name had to be found: People's Credit Funds (PCFs) – cooperative in nature but not in name. The PCF network was designed to comprise three types of institutions: (a) primary societies (PCFs) established in 1993; (b) a Central People's Credit Fund (CCF), established in 1995 together with Regional People's Credit Funds (RCFs); and (c) the Vietnam Association of PCFs (VAPCF), established in 2006.

At inception a steering committee was formed with the task of establishing a network of PCFs and guiding them throughout the duration of the pilot project. The committee comprised SBV as the lead agency, the Ministries of Finance, Planning & Investment, Government and Cooperatives and the Vietnam Cooperative Alliance. Its executive committee was placed in the SBV and consisted of officials of the SBV. To implement the establishment of PCFs, steering committees were formed at all levels of the administrative structure: central, provincial, district and commune. This was paralleled by a focal involvement of a newly established People's Credit Institution Division of SBV in Hanoi and in all its branches. DID provided technical support services during the start-up phase. In 1996 the Asian Development Bank (ADB) approved a loan to the PCF network, comprising $14.8 million for refinancing and $1.395 for equipment and training.

SBV provides a regulatory framework for the PCFs and licenses them. Through its branches it supervises their performance and compliance. SBV has the authority of closing non-performing PCFs. Prudential standards include a minimum capital requirement of D100 million (equivalent to $16,977 in 1993, around $6,000 in 2008; increased for new PCFs to

[4] Subsequently they were placed under the law on cooperatives of 1996, the law on credit institutions of 1997 and the decree on the model statute and operation of the PCF of 2001, amended in 2005.

D500 million in the provinces and D1 billion in Hanoi and HCMC), a risk-weighted capital adequacy ratio of 8%, a fixed asset ratio of at most 50% of equity, reserve requirements (placed interest-free at SBV) of 1% of Dong deposits and 8% of US$ deposits, a single borrower limit of 15% of equity (up from 10% at inception), adequate maturity matching (at most 10% of short-term deposits used for term loans) and observance of SBV's provisioning rules.

PCFs are subject to three types of oversight: daily internal control; regular random inspections by the SBV branch; and remote supervision by the SBV supervision department. PCFs send their financial and credit reports to the SBV branches as well as to the CCF branches. The SBV branches forward them to the PCF Division of the Supervision Department and the Credit Cooperative Institutions Department (CCI) of SBV. Online reporting is expanding, but not yet universal. Based on the monthly report, an SBV branch may intervene directly in case of irregularities or poor performance.

SBV provides a mandatory training program free of charge. Two units are involved: the People's Credit Institution Department (PCID) and the Center for Banking Research and Training (CBRT), which designed the curriculum and training materials. The actual training proceeds in two steps: CBRT trains the officers of the SBV branches; and the SBV branches train the PCF board members and staff. This is followed by training-on-the-job and monitoring by SBV officers instructing the PCF staff in all practical affairs.

PCFs are voluntary organizations with at least 30 members[5]. They are based on the principles of self-help, self-reliance, self-management and democracy. More concretely, they are formed by their members; self-financed through shares, deposits and retained earnings; professionally managed by a team of qualified employees under the control of a board; and the board is democratically elected by the members, all with equal voting rights. Unlike the former credit cooperatives, they are part of a network, which functions as a nation-wide system of mutual support. It provides model bye-laws and various apex services, including access to liquidity exchange and refinancing by a central fund. 95% of the PCFs are rural; given the ample supply of financial services in cities, SBV discouraged the establishment of urban PCFs. After an initial two tax-exempt years, PCFs are subject to income tax up to 28%, varying by province.

The board of directors consists of three to nine persons elected by the general assembly for a five-year term. Board members are usually experienced and respected citizens who played a leading role as founding members. The board decides on capital increases, interest rates within the range set by SBV, recruitment and expenditure. It also appoints the managing director, to be approved by the general assembly and confirmed by the local SBV branch. The chairman of the board may also serve as managing director. The credit committee decides on loans exceeding the managing director's lending authority. Internal control is placed in the hands of a supervision committee elected by the general assembly.

In the early years the Local People's Committee (LPC) took considerable influence. Establishing viable and sustainable financial institutions was a major concern of local government, aiming at the recycling of local financial resources and preventing their siphoning off to urban areas. The LPC first helped carrying out a feasibility study, preparing a business plan and organizing the establishment process including the application for a license. Subsequently it took joint responsibility with SBV to avoid a repetition of cooperative failure. Direct influence on management and business decisions has reportedly subsided with increasing experience of management and staff and growing confidence in cooperative self-management. The LPC still has a role to play when problems arise, to facilitate collection in case of defaulting, or to provide land for the premises of the PCF.

Management and staff have to be qualified and are remunerated for their work. SBV has a training program in bookkeeping, loan appraisal, loan administration, internal control and

[5] Initially 12, since April 1997 30 founding members living in the same commune. They elect a temporary board of directors and steer the establishment process.

cooperative management. Mandatory and voluntary training continue life-long, provided by SBV, CCF, VAPCF and other institutions.

Deposits are mobilized from members and non-members, individuals and organizations. PCFs offer attractive conditions: proximity which entails lower depositor transaction costs; diversified products including demand, term, regular and discount deposits (with prepaid interest); higher interest rates than in banks; and term deposit insurance under the Vietnam Insurance Company (BAOVIET). As a result deposits usually account for three-quarters or more of loans outstanding: a solid basis of self-reliance. Surplus deposits are placed at the central fund. Other financial services include bill payments and remittances. PCFs may also act as trust agencies for development programs.

Lending is restricted to members in good standing; PCFs may lend up to 10% of their portfolio to poor non-members. About 30% of the borrowers are women. The portfolio of PCFs is generally diversified, comprising loans for agricultural production and processing, crafts, services, trading, consumption and emergencies. The emphasis is on productive loan purposes, particularly in agriculture, the main occupation of most of the members. Loans for socioeconomic organizations and small enterprises are mainly for equipment, modernization and expansion. Procedures are kept simple. The appraisal process, collateral, loan loss provisioning, record-keeping and reporting are regulated by SBV. Most loans are secured, except small loans and loans to the poor. The most common collateral is land use and house ownership certificates – largely a formality as these are difficult to alienate. Both loans and deposits are mostly short-term (up to one year).

Interest rates were liberalized in 2002; but PCF boards felt morally obligated to keep lending rates low. As inflation rose from 6.6% in 2006 to 12.6% in 2007 and 22% in 2008, SBV returned to a restrictive interest rate policy to fight inflation. In May 2008, SBV set ceilings for PCFs at 21% p.a., lowered in December to 16.5%.[6] Deposit rates are around 8% to 9% p.a.

4. Growth of the People's Credit Funds

The pilot project establishing PCFs started in July 1993 and was to cover a seven-year period. The first 179 PCFs were set up during the second half of 1993 and in 1994. Overall the network has evolved in three phases, which are not sharply divided, as the number of PCFs, their membership and the volume of financial transactions did not evolve at exactly the same pace.

The start-up phase, 1993-1996, is marked by rapid growth in the number of PCFs and members, resulting in 847 PCFs with 378,978 members by the end of 1996. Total loans outstanding reached $91.2 million, deposits $60.3 million (66% of loans) and equity $9.05 million. Disbursements in 1996, the first year for which data are available, exceeded loans outstanding by more than 100%, indicating very short loan periods.

The second phase, 1997-2002, is marked first by a slowing-down of growth over a two-year period, followed by consolidation based on an evaluation after which SBV closed nearly 100 non-performing PCFs. By the end of 2002 the number of PCFs had fallen from a peak of 977 in 1998 to 888, while growth in the number of members was only slightly affected, reaching 850,781 in 2002. Loans and deposits continued to grow at a low rate, reaching $207 million and $154.0 million, respectively, at the end of 2002. Equity grew only slightly to $13.0 million. Borrowings from the central fund (CCF), the newly established refinancing apex of the network, started in 1997, with $18.4 million (16% of loans outstanding), and grew to $40.0 million (20% of loans) in 2002.

The current phase, since 2003, is characterized by three trends: cautious growth in the number of PCFs, with SBV closing about 3 PCFs per year until 2007 (none were closed in

[6] In 2009 the ceiling was further reduced to 11.55%, but consumer loans may be negotiated at a higher rate.

2008); continual growth in membership; and rapid growth in loans and deposits, indicating the members' trust in their cooperatives. By the end of 2008, the network covered 1015 PCFs with 1.35 million members. Total assets stood at $982.2 million, loans outstanding at $833.0 million, total deposits at $726 million – the main source of loanable funds, accounting for 87% of the portfolio. Equity had increased to $45.9 million, equivalent to 5.5% of the portfolio. At $131.8 million, borrowings fell back to 16% of the portfolio. Disbursements in 2008 exceeded loans outstanding by 56%, indicating that average loan periods continued to stay under one year. (Table 2)

Highlights of the evolution of the PCF network are summarized below.

Table 1: Highlights of the evolution of the network of PCFs

July 1993	Start of the pilot project establishing People's Credit Funds; first 179 PCFs established during 1993-94
1995	Central People's Credit Fund (CCF) established, together with a growing number of Regional People's Credit Funds (RCFs)
1997	Slow-down of expansion
1999	Assessment and subsequent consolidation of the network; nearly 100 PCFs closed in 1999-2002
2000	Official conclusion of pilot phase in March 2000; network reorganized into two tiers, PCFs and CCF; RCFs converted into CCF branches
2002	Growth of loans and deposits resumed
2003	Cautious expansion of the network resumed
2006	Vietnam Association of PCFs (VAPCF) established
2010	CCF expected to be converted into a commercial bank
2020	1700 PCFs expected to cover about 6,000 communes

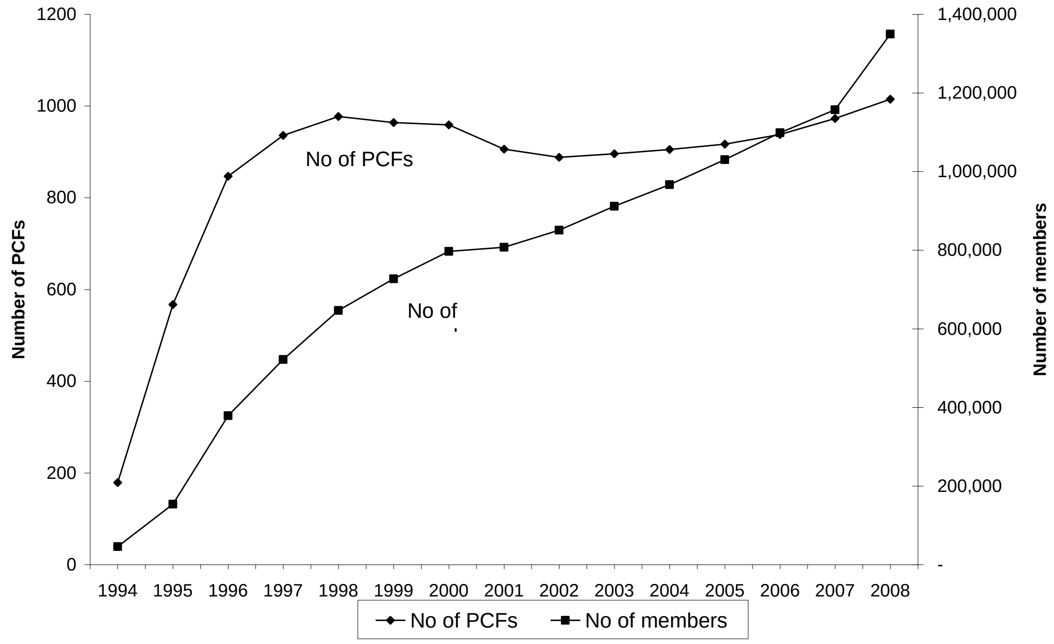
Table 2: The development of PCFs, 1994-2008 (amounts in million US$)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
No of PCFs	179	567	847	936	977	964	959	906	888	896	905	917	938	973	1015
1 Growth in number p.a.		*388*	*280*	*89*	*41*	*-13*	*-5*	*-53*	*-18*	*8*	*9*	*12*	*21*	*35*	*42*
No. closed by SBV	0	0	0	0	0	0	5	53	24	3	3	4	4	2	0
No of members	46,045	153,901	378,978	522,080	646,701	727,098	797,069	807,546	850,781	911,926	966,540	1,029,987	1,098,754	1,157,416	1,349,804
Av. no of members/PCF	*257*	*271*	*447*	*558*	*662*	*754*	*831*	*891*	*958*	*1,018*	*1,068*	*1,123*	*1,171*	*1,190*	*1,330*
No of borrowers				677,717	734,796	746,481	711,769	661,443	660,361	663,757	661,663	670,933	732,774	785,638	785.698
Balance sheet															
Total assets	7.6	40.67	120.81	128.91	133.74	163.39	184.2	196.15	232.14	303.11	371.01	458.74	585.98	850.71	982.17
Av. total assets/PCF	*0.042*	*0.072*	*0.143*	*0.138*	*0.137*	*0.169*	*0.192*	*0.216*	*0.261*	*0.338*	*0.41*	*0.5*	*0.625*	*0.874*	*0.97*
Loans - gross	6.59	34.9	91.16	114.61	116.17	140.46	161.9	169.64	200.66	259.09	322.5	404.44	511.3	731.11	833.04
Growth p.a. in percent		*430*	*161*	*26*	*1*	*21*	*15*	*5*	*18*	*29*	*24*	*25*	*26*	*43*	*14*
Disbursements	n.a	n.a	193.47	230.69	227.33	258.02	274.83	264.19	318.3	395.85	496.42	603.63	569.49	1,131.37	1,215.60
Deposits	5.01	24.69	60.26	80.86	85.63	107.39	117.85	129.41	153.97	205.23	250.05	299.75	389.65	582.47	726.24
Growth in percent		*392*	*144*	*34*	*6*	*25*	*10*	*10*	*19*	*33*	*22*	*20*	*30*	*49*	*25*
Borrowings				18.39	19.62	20.44	22.34	35.92	39.77	51.88	63.36	85.96	106.7	152.98	131.83
Equity	0.98	4.32	9.05	12.01	11.03	11.28	11.96	11.8	13	15.64	19.53	24.44	28.52	38.55	45.88
Av. equity/PCF	0.005	0.008	0.011	0.013	0.011	0.012	0.012	0.013	0.015	0.017	0.022	0.027	0.03	0.04	0.05
Net profit after tax*	0.26	1.15	3.13	3.52	2.76	3.55	3.18	3.96	4.89	5.8	7.19	8.79	10.54	10.24	10.81
Financial ratios (in %)															
CAR (not risk-weighted)	14.9	12.4	9.9	10.5	9.5	8	7.4	7	6.5	6	6.1	6	5.6	5.3	5.5
Overdues (≥1 days)	0.74	0.51	1.24	3.53	3.84	3.72	3.42	2.17	1.36	0.84	0.66	0.53	0.53	0.5	0.53
ROAA*							1.17	1.37	1.43	1.38	1.4	1.38	1.3	0.87	0.79
ROAE*							15	18	20	20	21	18	19	14	11
Loans-to-deposits	131	141	151	142	136	131	137	131	130	126	129	135	131	126	115
Deposits-to-loans	76	71	66	71	74	76	73	76	77	79	78	74	76	80	87
US$ exchange rate	*11,003*	*11,020*	*11,037*	*11,175*	*13,887*	*14,019*	*14,540*	*15,086*	*15,395*	*15,630*	*15,776*	*15,906*	*16,056*	*16,025*	*16,977*

Source: Based on data from SBV

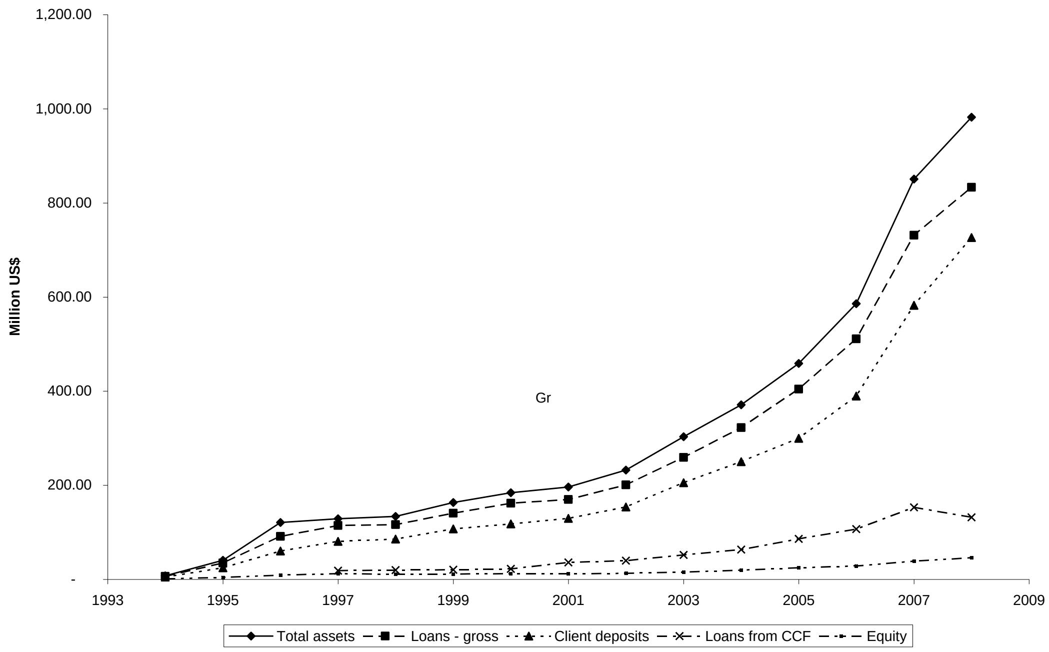
Figure 1 shows the exponential growth in the number of PCFs until 1996, the decline in the rate of increase in the following years when SBV closed a number of institutions, and slow growth since 2003. Membership grew rather steadily, with a flattening of the curve in 2000 and a sharp incline in 2008. PCFs have grown more than five-fold in average membership, from 257 per PCF in 1994 to 1330 in 2008.

Figure 1: Number of PCFs and members, 1994-2008



Since inception, total assets, loans outstanding and client deposits as the main source of funds have grown virtually in unison. (Figure 2) From 1994 to 1996 the three almost parallel curves grew steeply, followed by a flattening. 2002 marked a turn-around to an increasingly steep incline, with total assets, loans and deposits more than doubling in US$ terms during the last three years. Borrowings virtually stagnated at a very low level until 2000, after which they increased modestly until 2004. In 2005-07 they grew somewhat faster; but the rate of growth as indicated by the incline remained far behind that of total assets, loans and deposits. In 2008 they fell back, not only in US$ dollar terms (by 13.8%) but also in national currency (by 9.8%9). Equity has remained at a low level, its growth far behind that of the other curves – perhaps a source of weakness which might make it difficult for PCFs to cope with external shocks.

Figure 2: Total assets, loans outstanding, deposits, borrowings and equity of PCFs, 1994-2008



Broadening of outreach has been accompanied by financial deepening. Average deposit balances per member increased from $109 in 1994 and $155 in 1997 to $538 in 2008. Average loans outstanding per borrower increased from $169 in 1997 (the first year the number of borrowers was reported) to $1060 in 2008.

Overall the PCFs have performed extraordinarily well, both in quantitative terms of growth and in qualitative terms of repayment and profitability, the latter reduced however by the recent restrictive interest rate policy of SBV designed to regain macroeconomic stability. In 1994 and 1995 overdue ratios[7] were well below 1%. In 1996 they climbed to 1.2% and went up to rates ranging from 3.4% to 3.8% between 1997 and 2000. During the second part of the consolidation period they started to decline and stayed at 0.5% during the last four years – proof of the effectiveness of consolidation. Information on return on average assets (ROA) and equity (ROE) is available from SBV since 2000. Between 2000 and 2006 ROA fluctuated between 1.2% and 1.4%. In 2007 it declined to 0.87 and in 2008 to 0.79. The drop in profitability in 2007 and 2008 is not due to an intrinsic weakness of the PCFs, but is a result of interest rate restrictions imposed by SBV. Similarly, ROE started at 15% in 2000, climbed to rates between 18% and 21% and subsequently fell to 14% and 11%, respectively. No doubt, it is not only the PCFs which have performed well, but also SBV as a supervisor.

5. Growth of the Central People's Credit Fund (CCF)

CCF was licensed by SBV in 1995 as the apex cooperative financial institution of the PCF network. The CCF is a joint stock financial institution under the law of cooperatives, the law of credit institutions and the decree (of 2001) on PCF which also pertains to CCF. It is supervised by SBV. It is expected to be transformed into a commercial bank. CCF provides financial services to PCFs and the general public, including SMEs, farmers and CCF staff. In addition it provides technical assistance to PCFs and has been acting as focal point for the network in its external relations. There are 25 branches which operate as profit centers. Performance incentives may effectively double one's salary.

[7] Payments are considered overdue if late by one day or more. In actual fact borrowers are reportedly given a grace period of up 10 ten days before a payment is rated as overdue.

CCF is owned by the PCFs, four state banks and the Government as a special member represented by SBV, which also form the general assembly and the board of management. The legal capital as of 31 December 2007 amounted to $7.0 million, 73.2% of which were held by SBV. In early 2008 SBV injected D600 billion, bringing its share to 95.8%. The Government plans to increase legal capital to D2.0 trillion in 2009. There is a permanent supervisory board of three and an executive committee of six members. The accounting system is largely in line with international standards. Reporting is based on a format issued by SBV. The accounting department prepares a daily balance sheet, which is sent to all departments. The branches submit their data daily, with automatic overnight inclusion in a consolidated report. Risk management pertains to four major risks: credit, liquidity, market and interest rate risk. An internal auditing department is under construction.

CCF accepts deposits from PCFs since 1998 and from the general public since 2001. As of 31 December 2007 15% of total deposits came from PCFs, 40% from banks and 45% from other clients.

CCF has been lending to PCFs since 1995. Lending to SOEs started in 1998, in an effort to contribute to their viability. In 2001 CCF introduced consumer lending to individual clients. 52% is extended to PCFs, 7% to SMEs and 41% to individuals. 73% of the loans are short-term, 25% medium-term and 3% long-term. 84% of the portfolio is financed from own resources, 16% from donor credit lines. The feasibility of a life insurance product for loan protection is under study.

Interest rates in August 2008 stood at 4.8% p.a. on current accounts and 19.24% to 17.52% on term deposits. Lending rates varied from 16.8% to 21.0% on loans from own funds and from 13.2% to 19.8% on loans from project funds. The net interest rate margin was 2.95%. PCFs pay the lowest, individuals the highest interest rates. Due to interest rate uncertainty long-term loans (with an overdue ratio of 0.9%) were more expensive than short-term loans (with an overdue ratio of 1.5%).

There are two major phases in the evolution of CCF: a first phase of slow growth from 1995 to 2000, the end of the pilot project, during which the refinancing function of the CCF was paralleled by Regional Credit Funds (RCFs); and a period of rapid growth from 2001 to 2007, initiated by the merger of the RCFs with the CCF and the provision of retail financial services to the general public, which has laid the institutional foundation for the transformation of CCF into a commercial bank which is under discussion. The trend changed in 2008, which is discussed in the final chapter. During 1995-2000 average annual growth rates of total assets and loans outstanding were 40% and 69%, respectively; during 2000-2007 these rates were almost 150%. Deposit-taking started in 2000 near zero; hence meaningful percentages of growth cannot be calculated. In 2007 deposits accounted for a remarkable 96% of loans outstanding. Equity almost stagnated, growing during the two periods at an average of 0.3% and 7%, respectively. Growth rates of borrowings declined by 9/10th, from 513% to 54%, largely replaced by deposits. (Table 3)

Table 3: CCF: Increases of core balance sheet parameters, 1995-2000 and 2000-2007, amounts in million US$, average annual growth rates in percent

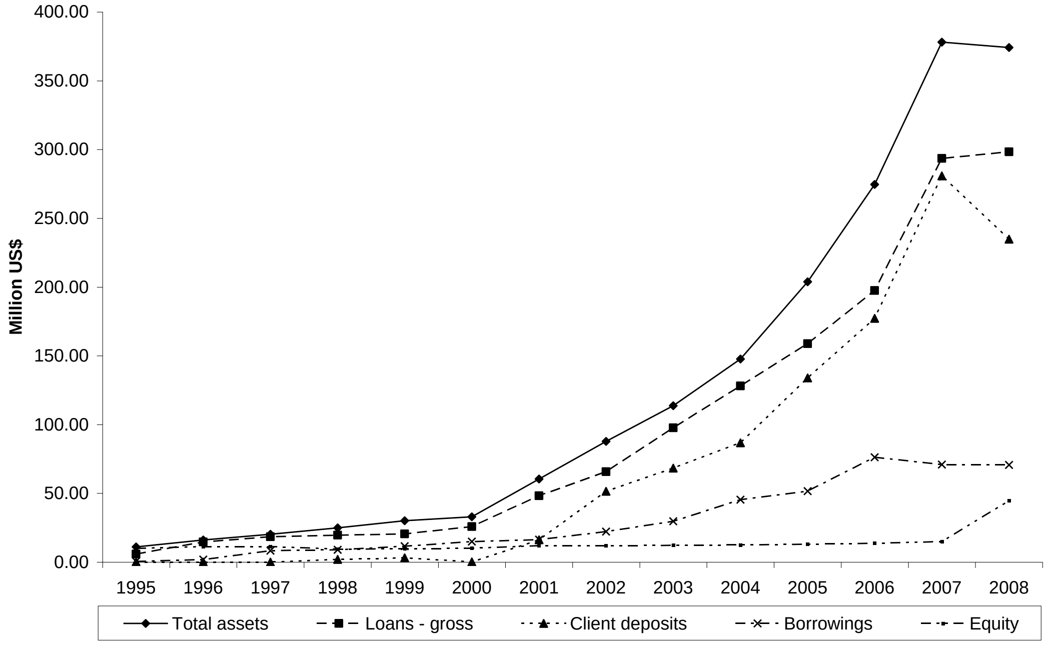
	Balance sheet data (in million US$)			Av. annual growth rates (in %)	
	1995	2000	2007	1995-2000.	2000-2007
Total assets	11.00	32.99	378.04	40	149
Total loans gross	5.78	25.79	293.51	69	148
Total deposits	0.00	0.15	280.83		
Total borrowings	0.56	14.91	70.98	513	54
Total equity	9.98	10.11	14.89	0.3	7

Source: CCF data

The turn-around of CCF led to a fundamental change in the structure of the balance sheet. Comparing percentages in terms of total passiva in 2000 and 2007, deposits surged from 0.5% to 74%, borrowings fell from 45% to 19%, and total equity dropped from 31% to 4%. This is paralleled by a decrease in the percentage of loans outstanding to PCFs in terms of total activa from 68% to 40%, and an increase of loans to other clients from zero to 37%. The overall result of the transformation has been a savings-driven institution with a diversified portfolio. Self-reliance through deposit mobilization has been the most outstanding outcome. By the end of 2007 CCF stood at 44% of the total asset size of PCFs.

Graphically the turn-around is shown in Figure 3. All curves are nearly flat up to 2000, indicating very low growth rates. In sharp contrast, during 2001-2007, there has been a more than ten-fold surge in total assets and loans outstanding (measured in US$); deposits grew from 7% of loans outstanding to almost 100%. Only the curve of total equity remained flat, with a growth of less than 50% over the seven-year period until 2007 (but over 400% by 2008 after a capital injection by SBV).

Figure 3: Total assets, loans outstanding, deposits, borrowings and equity of CCF, 1995-2008



The performance of CCF has been mixed but satisfactory overall. Overdue ratios have been moderate: they were near zero during the first three years for which data exist, 1998-2000, when CCF only lent to PCFs and RCFs. Due to the adoption of lending to the general public in 2001, the overdue ratio (≥1 day) of CCF surged from 0.25% in 2000 to 2.05% in 2001 and oscillated subsequently between a low of 1.0% and a high of 2.9%. In terms of profitability the best-performing years were 1996 and 1997: a liberal era in which the net interest margin was above 8%; the ratio of operational expenses over operational income was around 40%; and return on average assets was above 7%, which is exceptionally high. Since then the net interest margin, restricted by SBV policy, has been a modest 3% to 4% and stood at 2.95% in 2007, the lowest ever. From 2000 to 2007 net interest income grew by more than 900%; but efficiency went down as costs surged, as indicated by the increase in the ratio of operational expenditure over operational income from 57% in 2000 to peak of 91% in 2002; in 2007 it stood at 68%, which is quite satisfactory. Return on average assets has come down substantially. In 1998-2000 it roughly oscillated around 2%. Between 2000 and 2007 net profit after tax only doubled; return on average assets declined from 2.2% to 1.2% in 2001 and stagnated at 0.4% during 2005-07 due to a repressive interest rate policy. This ratio is far too low for an otherwise well-performing institution, particularly in light of its expectation to be transformed into a commercial bank. In the inflationary environment of 2008, SBV does well to impose a tight money policy and raise interest rates. But a cap on interest rates – in an effort to keep inflation low – is the wrong instrument. This puts the health of an otherwise sound credit cooperative sector at risk.

5. Growth and resilience during the global crisis

The global financial crisis began in July 2007 in the US with a loss of investor confidence in securitized mortgages; it spread and intensified throughout 2008 and has turned into a global economic crisis. Vietnam's export-driven economy was affected by a downturn of global demand and inward investment. The economy was not shattered, it expanded by 6.18% in 2008; but this was the lowest level in almost a decade. During the first quarter of 2009 Vietnam was one of the few countries with positive growth; yet its GDP growth of 3.1% was the lowest on record.

Over the past year concerns have been voiced that the crisis might seriously affect the microfinance industry worldwide. We surmise that effects will vary widely, depending, among other factors, on the self-reliance of institutions and their exposure to the inflow of external capital. Field work for this study was done in August 2008, before the impact of the global crisis was fully felt. As the crisis spread, the question arose whether and how it affected the PCFs. PCFs are financed through member deposits as their main source of funds (74% of passiva, 87% of loans outstanding in 2008). Other sources of funds comprise member shares and retained earnings. At 13% loans from CCF are but a fraction of passiva. When requesting an update until December 2008, our hypothesis was that impact would be quite limited.

However, economic reality is complex, and there are other factors at work which might influence the growth and performance of the PCF system. Inflation in Vietnam increased from 6.6% in 2006 to 12.6% in 2007 and surged to 22% in 2008 according to SBV. As in many other developing countries, this was initially due to rising food and energy prices, which were unrelated to the crisis. Subsequently inflationary pressures might have been increased by the crisis, particularly in light of the fact that food and energy costs declined in the second half of 2008. The possible impact of inflation on the PCFs has been exacerbated by the central bank's attempt to stem inflation with a ceiling on interest rates, a policy which diminishes profitability. As a result, interest rates in 2008 turned negative in real terms, last seen in 1989. The question of resilience is thus a wider one: how did PCFs fare under the onslaught of global crisis, inflation and financial repression?

With regard to CCF, the central fund of the PCFs, the situation might be different. CCF derives only 13% of its passiva from PCFs; the main source of funds are deposits by other, mostly urban, clients (50% of total passiva). Borrowings account for 19% and equity for 12% of passiva (2008). Both types of institutions, PCFs and CCF, are savings-based; but they differ in that PCFs fully rely on local rural markets, while CCF is to a considerable extent integrated into urban markets and thus more exposed to global as well as wider domestic influences. Does this show in its performance?

The PCF network expanded by 4.3% in 2008, more than in the preceding years; and for the first time since 2000, no PCF was closed by SBV. Membership grew by an unprecedented 16.6%; but the number of loans outstanding stagnated. (Table 1, Figure 1) In US$ terms growth continued at an impressive rate as visualized in Figure 2. Total assets grew by 15.5%, loans outstanding by 13.9%, deposits by 24.7% and equity by 19.0%.[8] Yet the growth rates in 2008 are lower than those of 2007, which were exceptionally high compared with already

[8] Due to a deterioration of the currency, growth rates in Dong terms are slightly higher: 20.8%, 19.2%, 30.4% and 24.5%, respectively.

high growth rates in preceding years. Thus, growth continued to be strong in 2008, but at a lower rate than in 2007 and 2006. Borrowings had increased by 43.4% in 2007 and decreased by 19.0% in 2008: mostly due to lesser loan demand. At the same time it is a sign of self-reliance as indicated by the increase in the deposit-to-loan ratio from 76% in 2006 to 80% in 2007 and 87% in 2008. (Table 2) The decline in borrowings is not due as one might suspect to a drying up of international funds channeled through CCF; in fact, these increased by 16.9%, far more than in previous years.[9]

Table 4: Growth rates of PCFs, 2005-2008 (in percent, amounts based on US$)

	2005	2006	2007	2008
Outreach:				
No of PCFs	1.3	2.3	3.7	4.3
No of members	6.6	6.7	5.3	16.6
No of borrowers	1.4	9.2	7.2	0.0
Balance sheet				
Total assets	23.6	27.7	45.2	15.5
Loans - gross	25.4	26.4	43.0	13.9
Deposits	19.9	30.0	49.5	24.7
Borrowings	35.7	24.1	43.4	-13.8
Equity	25.2	16.7	35.2	19.0

Source: Based on Table 2

The overall economic situation apparently did not have an impact on the ability and willingness of PCF members to repay their loans: for the past four years, including 2008, the overdue ratio (≥1 day) stayed at 0.5%. In 2007 performance of the PCFs declined, a trend which continued into 2008: ROA[10] declined from 1.30% in 2006 to 0.87% in 2007 and 0.79% in 2008; correspondingly, ROE fell from 19% to 14% and 11%. (Table 2) The decline in profitability in 2007 was due to two factors which depressed earnings: a more conservative provisioning policy and stronger competition which kept PCFs from lowering their deposit interest rates. As a result net income after tax stagnated and failed to keep pace with portfolio growth. Compared to that, interest rate restrictions as of May 2008 had surprisingly little additional impact in 2008.

From 2001 to 2007 the growth pattern of CCF has been overwhelmingly positive and similar to that of the PCFs, with rates of growth of CCF overall somewhat higher, as visualized in Figure 2 and Figure 3. The pattern in 2008, however, is fundamentally different. The growth of total assets, at 37.7% in 2007 (and similarly high rates in the years before), came to a standstill in 2008, at an unprecedented -1.0%. Similarly, the growth of the loan portfolio fell from a spectacular 48.6% in 2007 to 1.7% in 2008. Deposits fell even more dramatically: from 58.4% to -13.8%.

The two client groups of CCF reacted differently to the recession: the PCFs deposit more in the CCF and borrow less; other clients deposit less and borrow more. More specifically, from 2007 to 2008 the share of the PCFs in the deposit portfolio grew from 15% to 20%, while their share in the loan portfolio fell from 52% to 44%. Correspondingly, the share of other clients in the CCF's deposit portfolio fell from 85% to 80%, while their share in the CCF's loan portfolio grew from 48% to 56%. The changes in the growth rates of the various balance sheet parameters since 2005 are given in Table 5. From 2007 to 2008 the growth rates of deposits by PCFs fell from 90.2% to 14.1%, compared to respectively 53.9% and -21.8% of other clients; growth rates of loans to PCFs fell from 43.4% to -13.8%, while growth rates of loans to other clients fell from 54.7% to 18.5%.

[9] Domestic borrowings fell from $20.6 million in 2006 and $9.3 million in 2007 to zero in 2008.
[10] ROA and ROE as given by SBV are unadjusted; they do not take into account the loss in value of capital due to inflation.

Unrelated to the crisis, the rate of growth of equity surged from 8.6% in 2007 to an astronomical 199.2%. This is owed to a substantial investment of SBV, which brought equity up from $14.9 million in 2007 to $44.55 million in 2008, presumably in preparation of a transformation into a commercial bank. CAR (risk-weighted) surged from an all-time low of 10.1% to 30.9%.

There was no drying up of donor credit lines in 2008. These have risen continuously since 1997. During the last three years they not only rose in absolute terms, but their growth rate also went up: from 9.1% in 2006 and 12.3% in 2007 to 16.9% in 2008, reaching $65 million. This was accompanied by a reduction of domestic credit outstanding over the past three years, which declined from $20.6 million in 2006 to zero in 2008. (Table 2, Table 5)

Table 5: Growth rates of CCF, 2005-2008 (in percent, amounts based on US$)

Balance sheet	2005	2006	2007	2008
Total assets	38.0	34.7	37.7	-1.0
Total loans gross	23.9	24.4	48.6	1.7
Loans to PCFs	*35.7*	*24.1*	*43.4*	*-13.8*
Loans to other clients	*12.5*	*24.7*	*54.7*	*18.5*
Total deposits	54.4	32.4	58.4	-16.4
Deposits of PCFs	*1.7*	*43.7*	*90.2*	*14.1*
Deposits of other clients	*65.6*	*30.9*	*53.9*	*-21.8*
Total borrowings	13.7	47.6	-6.8	-0.4
Domestic borrowings	*-93.3*	*9,266.1*	*-54.9*	*-100.0*
Donor credit lines	*26.4*	*9.1*	*12.3*	*16.9*
Total equity*	4.3	5.7	8.6	199.2

Overall impact of the turmoil in 2008 on the financial performance of CCF has been moderate. Since CCF started lending to the general public overdue ratios (≥1 day) have been fluctuating between 1% (2004) and 2.9% (2005). In 2007 CCF had succeeded in bringing the overdue ratio down to 1.3%; but in 2008 it jumped to 3.1% - evidence of repayment problems, but still at a moderate level given the strictness of the definition. Efficiency as measured by the ratio of operational expenditure over operational income declined slightly, from 68% to 73%. Under pressure to charge “affordable” interest rates, ROA, unadjusted for inflation, has been historically declining from 7.8% in 1996 to values significantly below 1% after 2001, stabilizing at 0.43% between 2005 and 2007. In 2008 ROA further declined slightly to 0.37%.

By way of conclusion, credit lines have played only a small role in the financing of PCFs and CCF; and there has been no drying up of donor funds in 2008 which might have affected the network during the global crisis. In 2008, PCFs with their purely local rural clientele proved resilient. Total assets, loans outstanding and deposits continued to grow almost unimpeded at high rates. Only the number of loans stagnated as some members worried about the future. Also, members honored their repayment obligations, with overdue ratios constant at a level near zero. The central bank’s attempt to control inflation (related to the prior rise in food and energy prices) by imposing interest rate ceilings in 2008 depressed the profitability of the PCFs only slightly. Earnings had been more affected in 2007 by a more conservative provisioning policy and competition, which prevented PCFs from lowering their deposit rates. It also appears that PCFs are more concerned with low lending rates than profit maximization, particularly as their main source of funds are deposits, not retained earnings.

CCF serves urban corporate and individual clients to a considerable extent and, in particular, relies largely on their deposits. Since CCF began serving the public, in 2001, its growth has been spectacular, exceeding even that of the PCFs, but only until 2007. In 2008 growth of total assets and loans outstanding came to a standstill; deposits, which are mainly mobilized from clients other than PCFs, declined. Compared with previous years, in 2008, PCFs deposited more in CCF and borrowed less, while other clients deposited less and borrowed more. Exposure to urban markets, previously the strength of the CCF, now turned into a liability, disrupting the previously unabated growth pattern. As a result, total asset size of CCF relative to the PCFs declined from 44% in 2007 to 38% in 2008. Yet, in terms of financial performance CCF has coped rather well with the impact of the global crisis and inflation on its clients. Overdues went up, but not to an alarming degree. Efficiency went down slightly, and so did profitability. But more serious than external threats has been an overall culture of interest rate moderation which is characteristic of many credit cooperative systems – quite the opposite of many other types of microfinance institutions – and the re-enactment of interest rate controls. One may hope that due to their self-reliant growth over a long period, both PCFs and CCF possess the inner strength to also cope with economic and policy challenges in 2009.

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Annex 1: CCF financial data, 1995-2008 (in million S$)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Balance sheet														
Total assets	11.00	16.04	20.24	24.84	30.14	32.99	60.39	87.83	113.69	147.67	203.80	274.59	378.04	374.16
Total loans gross	5.78	14.63	18.39	19.62	20.44	22.34	48.29	65.70	97.63	128.14	158.82	197.53	293.51	298.39
Loans to PCFs, RCFs in %	*100%*	*100%*	*100%*	*100%*	*100%*	*87%*	*74%*	*61%*	*53%*	*49%*	*54%*	*54%*	*52%*	*44%*
Total deposits	0	0	0.02	1.89	3.07	0.15	16.24	51.46	68.35	86.71	133.91	177.28	280.83	234.75
Deposits of PCFs in %			*100%*	*100%*	*100%*	*100%*	*29%*	*12%*	*20%*	*17%*	*11%*	*12%*	*15%*	*20%*
Total borrowings	0.56	1.87	8.31	8.96	11.57	14.91	16.38	22.18	29.74	45.38	51.62	76.19	70.98	70.72
Donor credit lines in %	0%	0%	78%	100%	94%	84%	89%	83%	95%	79%	88%	65%	78%	92%
Total equity*	9.98	11.25	11.31	9.46	9.65	10.11	11.91	11.77	12.13	12.44	12.97	13.71	14.89	44.55
Profit/Loss														
Net interest income	0.48	1.39	1.66	1.01	1.09	1.17	2.02	2.49	3.12	4.27	7.01	8.37	10.79	13.09
Net profit before tax	0.36	1.06	1.36	0.72	0.76	0.84	0.81	0.75	0.75	0.92	1.06	1.42	1.94	1.86
Net profit after tax	0.36	1.06	1.36	0.39	0.64	0.71	0.55	0.51	0.52	0.66	0.76	1.02	1.40	1.34
Financial ratios (in %)														
CAR, risk-weighted	n.a.	n.a.	n.a	35	37	32	36	35	34	25	17	13	10.1	30.9
Overdues, ≥1 day	n.a.	n.a.	n.a	0.06	0.09	0.25	2.05	2.06	1.24	1.02	2.9	2.3	1.3	3.06
Return on average assets**		7.81	7.49	1.75	2.33	2.23	1.18	0.69	0.51	0.51	0.43	0.43	0.43	0.37
Return on average equity**			12.05	3.79	6.69	7.14	4.99	4.29	4.33	5.40	5.99	7.64	9.79	4.57
Net interest margin	4.35	8.67	8.18	4.08	3.61	3.73	3.46	2.97	2.88	2.99	3.55	3.15	2.95	3.76
Op.exp./op.income	24.34	38.97	41.61	61.19	70.08	56.65	84.86	91.16	74.16	74.68	58.56	66.32	68.17	73.29
Deposits-to-loans	0	0	0	10	15	1	34	78	70	68	84	90	96	79
US$ exchange rate	11,020	11,037	11,175	13,887	14,019	14,540	15,086	15,395	15,630	15,776	15,906	16,056	16,025	16,977

* Equity for 1995 is estimated.

** After taxes, calculated over the average of beginning and end of year