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FACTORS AFFECTING MICROFINANCE
DEVELOPMENT IN VIETNAM

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ABSTRACT

The appearance of microfinance has been known as a remedy for many social ills rooted in poverty because of its efficacy in credit dispensation, social equality enhancement and reduction of poverty. Millions of poor and non-bankable people in developing countries have been provided access to formal financial services through microfinance programs. However, the development of microfinance is not a single model for all country and microfinance institutions (MFIs) have had various degree of sustainability. Many MFIs still face major constraints in their pursuit of effectively delivering microfinance services profitably. Expansion of microfinance programs remains a formidable challenge for the development of microfinance industry. What would be reasons for that inefficiency?

This thesis seeks to contribute to the current state of knowledge and research thoroughly on the development and the characteristics of microfinance industry by investigating strategic factors affecting microfinance development in Vietnam context. It applies both qualitative and quantitative research methods.

We develop comparative analysis between financial innovation of Vietnam microfinance system and two other international benchmarks namely Grameen Bank in Bangladesh and the Bank Rakyat of Indonesia (BRI) to figure out what constraints limit the scale and scope of Vietnam microfinance activities; what types of microfinance models are suitable: whether for-profit commercial models or social microfinance ventures in Vietnam context. Besides, empirical work is carried out using both OLS and GMM techniques to examine the impact of institutional environment as well as macroeconomic factors on MFIs' profitability. The results present evidence on a dynamic role of profitability and economies of scale in microfinance. Loan quality seems to be a very important determinant of MFI's profitability in Vietnam. Our analysis also confirms the significant role of State level as well as the decisive role in self-innovation of microfinance institutions.

Keywords: *Microfinance, microfinance institutions, financial performance, financial innovation, profitability, sustainability,*

RESUME EN FRANÇAIS

L'émergence de la micro-finance a été vue comme un remède pour un grand nombre de problèmes sociaux issus de la pauvreté en vertu de son efficacité dans l'octroi de crédits, dans l'amélioration de l'équité sociale ainsi que dans la réduction du niveau de pauvreté. Des millions de foyers en dessous du seuil de pauvreté n'ayant pas accès aux services bancaires ont ainsi pu accéder à des services financiers au travers de programmes de micro-finance.

Cependant, le développement de la micro-finance ne suit pas un modèle identique pour tous les pays et les Institutions de Micro-finance (IMF) ont eu différents degrés de rentabilité. Beaucoup d'entre elles doivent encore faire face à des contraintes majeures pour fournir de manière efficace des services de micro-finance rentables. L'expansion des programmes de micro-finance reste un grand défi qui fait barrière au développement du secteur de cette dernière. Quelles pourraient être les raisons expliquant cette inefficience ?

Cette thèse a pour but de contribuer à l'état des connaissances actuelles ainsi qu'aux recherches sur le développement et les caractéristiques du secteur de la micro-finance en analysant les facteurs stratégiques pouvant avoir un effet sur son développement dans le contexte du Vietnam. Pour ce faire, il sera appliqué à la fois des méthodes de recherche qualitatives et quantitatives.

Nous effectuerons une analyse comparative entre l'innovation financière dans le système de micro-finance du Vietnam et deux modèles de référence internationaux : la Grameen Bank et la banque Rakyat d'Indonésie (BRI) afin de déterminer quelles contraintes limitent l'ampleur et la portée des activités de micro-finance au Vietnam ; quels types de modèles de microfinance sont adéquats : que cela soit pour des modèles commerciaux à but lucratif ou pour des projets de micro-finance sociale. Par ailleurs, des analyses empiriques seront portées par les techniques OLS et GMM afin d'examiner l'impact de l'environnement institutionnel ainsi que des facteurs macroéconomiques sur la rentabilité des IMF's. Les résultats donnent la preuve d'une persistance de la rentabilité et de l'existence d'économies d'échelle en micro-finance. La qualité des prêts semble être un facteur déterminant concernant la rentabilité des IMF's au Vietnam. Notre analyse confirme également le rôle important de l'État ainsi que le rôle décisif dans l'auto-innovation des institutions de microfinance.

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List of Acronyms and Abbreviations:

ADB: -Asian Development Bank

BRI: -Bank Rakyat Indonesia

Co-op Bank: -Co-operative Bank

CGAP: -Consultative Group to Assist the Poor

GMM: -General Method of Moment

IMF: -International Monetary Fund

MFI : -Microfinance Institution

MIX: -Microfinance Information Exchange

MO: -Mass Organization

NGO: -Non-Governmental Organization

OLS: -Ordinary Least Square

PCF: -People Credit Fund

ROA: -Return on Asset

USD: -United States of American's Currency (USD)

UN: -United Nation

VBARD: -Vietnam Bank for Agriculture and Rural Development

VBSP: -Vietnam Bank for Social Policies

VND: -Vietnam Dong

CHAPTER I

INTRODUCTION AND PROBLEM STATEMENT

1.0   GENERAL INTRODUCTION

Microfinance is globally known with its successful role in poverty reduction and gender equality and social development. Therefore, it has been regarded as a very effective tool for sustainable social and economic progress especially in developing countries. Policy makers are engaging in how to develop microfinance sustainably and make it available for their lower income population in future.

In Vietnam, for nearly three decades, microfinance has made a major contribution to helping the poor improve their lives through the provision of banking and financial services especially small loans for their productions and business activities. The continuing growth of microfinance toward sustainable development has been a crucial component for international integration and social economic development. The interest of this thesis was to figure out and analyze potential factors affecting the development of microfinance in Vietnam. These can also be understood as sustainability of microfinance industry and the permanent performance of microfinance institutions (MFIs) which are means to conduct microfinance activities. MFIs can be considered sustainable if they maintain a proportional balance between certain critical elements: long-term profitability; providing sustainable microfinance facilities to the poor and contributing benefits to society, community and environment. For MFIs to fulfill their target of sustainability, it will depend largely on their capacity to finance and promote innovation as well as on the environment in which microfinance operates.

1.1   BRIEF HISTORY OF MICROFINANCE

The term of "Microfinance" is very popular with the world today. It has experienced a long history with the original root lying in numerous traditions and informal systems of credit in developing economies since centuries. Many of the current microfinance practices derive from community based mutual credit transactions that were grounded on trust, peer-based non-collateral borrowing and repayment. The mid 1980s marked a turning point for the microfinance sector when it tremendously grew and transformed vastly into a significant and self-sustaining industry. It is reported that more than 3,652 microfinance institutions (MFIs) have been serving for 205,314,502 million clients worldwide (State of the Microcredit Summit Campaign Report2012page 3, by Larry Reed, Jan Maes).

Professor Muhammad Yunus, a lecturer of Economics at Chittagong University, is known as "the father of microfinance", once visited to a poverty stricken and flood ravaged Bangladeshi village of Jobra in 1976, when seeing a desperate poverty in that area, decided to lend about 27$ (free of interest) as working capital to a few women there. To his surprise, the women used the money productively in their modest commercial enterprises effectively and repaid the loan with thanking. That small loan was considered as providing the first amazing bricks to build a global movement aiming at alleviating poverty by providing impoverished people with access to credit. According to Professor Yunus, lacking traditional forms of collateral, especially land, prevented the poor from approaching to the mainstream financial services. Thus, Professor Yunus's alternative way to overcome collateral barriers, is forming borrower groups where peer group-pressure or mutual liability would guarantee repayment. This successful experiment was to become the basis of a global revolution popularly known as microfinance.

The emergency of microfinance has been considered as the answer for the poor who were excluded by formal financial organizations. Microfinance aims at poor and vulnerable non-poor customers who have a relatively unstable source of income. They are typically self-employed, often household-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade. In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Their financial demands used to be only satisfied thanks to informal or community-based financial arrangements. But microfinance creates access for them to productive capital, together with human capital, education and training and social capital, through local organization building. Microfinance enables them to move out of poverty. (Otero 1999).

The role of Microfinance isn't limited only to providing capital to the poor to combat poverty on an individual level; it also brings changes at an institutional level. The aim of Microfinance is to create institutions that deliver financial services to the poor that cannot be provided by traditional finance. Microfinance institutions have been established to address this market failure. The organizations that offer financial services to the very poor exist in various types of institutions: credit unions, non-governmental organizations (NGOs), cooperatives, and sectors of government banks. By addressing the gap in the financial market, an MFI can gradually become part of the financial system of a country and dramatically increase the number of poor clients. The 19th century marked the first participation of formal financial institutions in providing semi-formal microfinance services in Europe, particularly in the United Kingdom, Germany, and Italia. Since then, microfinance has blossomed throughout the world. The important role of microfinance in economic development and poverty reduction is more and more consolidated with the declaration of 2005 as the year of microcredit by the United

Nations[1]. At that time, the UN Secretary General Kofi Annan said, "microcredit was critical anti-poverty tool, emancipating women and empowering the poor and their communities". Muhammad Yunus even claimed optimistically that, thanks to microcredit, the next generation will only find poverty in museums. One year later, with establishment of the first microfinance bank in the world: Grameen Bank in Bangladesh, a Nobel Price on Peace was given to Professor Yunus for "his efforts to create economic and social development from below".

The development of the microfinance industry represents an accomplishment in economic history, since it helps erasing traditional conservative perceptions of economists and researchers in the world. It has overturned established ideas of the poor as consumers of financial services, shattered stereotypes of the poor as not bankable, spawned a variety of lending methodologies demonstrating that it is possible to provide cost effective financial services to the poor. Microfinance offered a potential solution to alleviate poverty while paying for itself and perhaps even turning a profit. This major innovation perhaps more than anything accounts for the emergence of microfinance onto the global stage.

Nowadays, microfinance landscape has experienced a lot of changes. Its development showed that microfinance is no more an isolated marginal sector of informal means of financing but rather constitutes a separate, lower-end segment of the broader financial system, and a locomotive of economic growth. The target of building an inclusive financial sector consisting of a suitable microfinance system became a common strategy in economic development of countries all around the world especially in developing countries like Vietnam.

Global Trends of Microfinance

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[1] *International Year of Microcredit website: http://www.yearofmicrocredit.org/pages/whyayear/whyayear_quotecollection.asp*

Microfinance has evolved tremendously over the last three decades. From a marginal phenomenon, on the side of or next to traditional banking systems, finance for the poor has become mainstream finance in the poor countries. Microcredit now was no long associated with the image of women gathering under the tree in Bangladesh to collect their savings and get small loans. The current microfinance looks entirely different in terms of the clients that are being served, the range of offered financial services, type of institutions involved and their delivery channel as well as funding sources. The estimated number of microfinance institutions is 10 000 worldwide ranging from non-profit NGOs, Credit Union to commercial banks, of which 1300 institutions often report and update performance data to Microfinance Information Exchange (MIX) to support transparency accounting[2]. The stock of foreign capital invested in the sector witness the triple increase to USD4 billion between 2004-2006 and keeps growing and now stands at USD 10 billion, of which more and more proportion comes from private sector who can see microfinance as some very attractive assets.

Relationships between clients and providers have no longer be simple between the poor and a socially aware MFI. Various types of relationships can be visualized as follows:

Table 1: Different types of relationships between microfinance providers and their clients

Providers	Products	Clients
Banks	Micro loan	(Poor) Families
Financial Companies	Small loan	Micro entrepreneurs
NGOs	Educational loan	Small famers
Saving and Credit retailers	Credit card	Families in their different
Big box consumer retailers	Mortgage	roles as consumers, house

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[2] MIX information. website: http://www.themix.org/mixmarket

Insurance Companies	Consumer loan	builders, parents, savers, insurance-takers,
Property Developers	Checking account	
Money Transfer Agencies	Saving account	
Mobile phone Companies	Foreign currency account	
Other new provider	Remittance	
	Supplier credits	
	Leasing	
	Another new product	

Source: Microned/TriodosFacet.
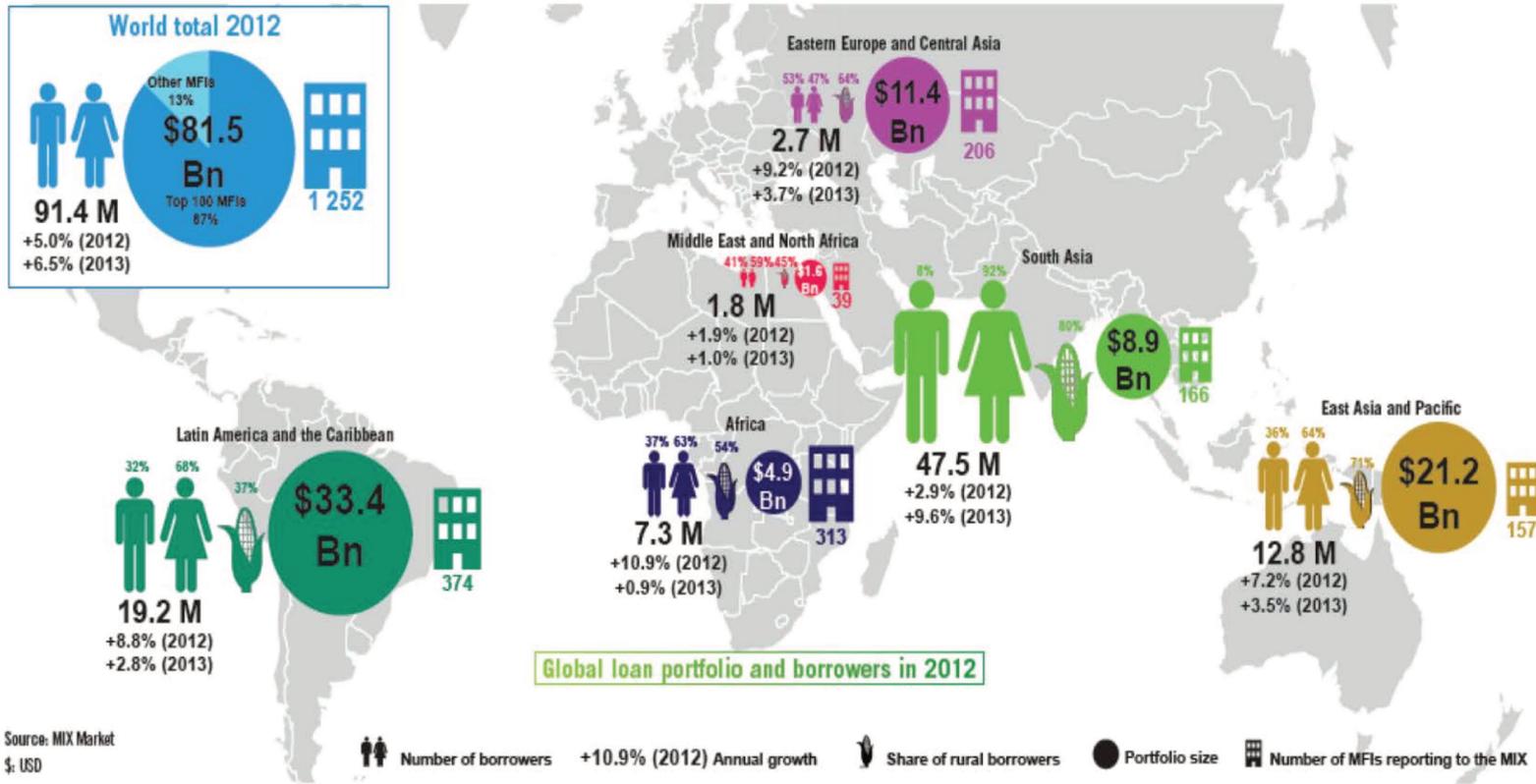
Source: Findex Data

Microfinance through its successes in last three decades has improved its valuable contribution to achieve the target of the Millennium Goals that number of people living in extremely poverty reduced by half between 1990-2015. Household income of families with access to credit is significantly higher than for comparable households without access to credit. Increased household income improves nutrition, and increases the probability that poor children from poor families will go to school. Microfinance programs have facilitated the graduation of poor households' clients to a status where commercial sectors of developing countries, banks especially, can meet the needs of the poor for credit, savings services, insurance, money management advice and financial planning. (Eugene Versluysen). However, during the development process, new trends appeared which could decisively contribute to the further growth of microfinance in future.

+ <u>There is a shift to collateral-lending in microfinance sector:</u> At the beginning, microfinance only focused on the extreme poor and vulnerable poor clients especially women who are considered to have better repayment abilities than male clients in developing countries. Now microfinance clients increased remarkably from the very poor, receiving 50 USD loans to small enterprises and trade with loans to tens of thousands USD in both developing and developed countries. Many microfinance institutions tend to be commercialized as they extended to clients in all kinds of nature with different demands as well as the target of being self-sufficient, This move led to changes in the lending method from less profitable group-lending to individual-lending, mainly targeting entrepreneurs. But with the shift to individual-lending, MFIs required material collaterals from their credit clients like lands or house. However, using collateral means that microfinance is backward to the old-fashioned lending models and that this movement will prevent women from accessing to micro loans because in developing countries, they have only limited access to owning their property.

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It is ironic because at the first stage of microfinance it was women who created motivations for the development of a new borrowing method. This shift leads to the possibility of distortion of microfinance's historical social mission. In fact, the best defense against this drift must come inside of microfinance institutions themselves. Because staying with the poor still promise a huge market with of large demand of approximately 2,5 billion poor people who have never had formal account in financial institutions (microfinance bara-meter, 2014). And for further development, microfinance will continue require a lot of support from non-commercial initiatives and development institutions. There is still a very promising market for microfinance institutions to explore, as they pilot this new process, provide new products in order to reach their clients more and more, and bring them to the radar commerce. By doing that, microfinance institutions for development have to know not only how to improve their supply capacity but strengthen their capacity to satisfy demand.

+ New providers coming and new partnerships between a more diverse set of actors: Banks after recognized the potential of the poor, very soon downscaled and came back to pick up clients that used to be not their interest. By the time, their presence in microfinance market has been overwhelming thanks to their big assets, capital funds as well as network branches. They integrate microfinance into their mainstream commercial retail. Other providers like supermarket chains, insurance companies … also discovered the market of the poor and come in with different strategies of downscaling. At the same time, former non- Government Companies and Microfinance Institutions fully transformed to register, working as a bank but still serving poor clients and introducing modern retail banking services to the poor population. For non- bank MFIs, typically because of legacy limitation or incapability to perform services, they choose to combine with commercial banks to create a linkage to commercialize microfinance. In that linkage, microfinance institutions become a crucial channel for

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commercial bank to disburse their loan capital to on- lend especially in funding for small enterprise in rural or remoted areas. They also can benefit from banks by obtaining necessary funding, investment and technical assistance. In turns, Banks will be able to help their clients by offering a complementary alternative, while achieving their service objectives and narrowing recognized gaps in the market which they couldn't penetrate before due to their structural rigidity. The new linkage nature is the scale- up of microfinance institutions to "access higher levels of credit, augment their portfolios, and strengthen management and efficiency levels," and the scale- down of commercial bank to profit from this emerging industry. They both redesigned their financial products to suite the clientele they are targeting. Subsequently the fruitful result of this new effective collaboration could be seen in more job creation, investment and growth of microfinance performance.

+ Funders and funding is not only the role of public money: Already, the number of borrowers served by Microfinance Institutions is around 10 million. With an average loan size of USD170, the total market size is estimated USD17 billion. But the potential market is at least more than 20times of current market with more than 2 billion global working poor. To finance the strong demand, MFIs need a huge amount of fund. However, there is no deficit of funding in this profitable and socially rewarded market thanks to a wide range of public funders and private organizations, from across the investment landscape. These actors have committed billions of dollars in a global effort to advance financial inclusion. International funding for microfinance reached at least $29 billion in 2012, (according to CGAP's Cross-Border Funder Survey). Still public funding grew faster. The financial crisis might have made more cautious for private funders and slowed down their investment but the money is going to come back and will do so in even larger amounts. Partly because microfinance as an investment opportunity has demonstrated its strength and resilience in the face of the crisis.

Public funders offer a range of funding instruments, including grants, investments, and support in the form of technical assistance. Poverty reduction, improved economic conditions, and social welfare are among their main priorities. For private investors, the incentive is the return on investment, whether financial, social, or both. Investments are made using debt, equity, or guarantees and are typically directed to refinancing and strengthening the capacity of loan portfolios, improving market infrastructure, and refining the regulatory environment.

In response to the growing interest in financial inclusion, many intermediaries holding companies, such as microfinance investment vehicles, have been established. Their clients may be both local and international, and they often have a focus on the so-called double bottom line approach of financial performance and social performance.

Domestic sources of fund also become more important: saving, bank funding, and bond. Parties like Compartamos (Mexico) and WWB Cali/Colombia have been pioneers in raising money on the local commercial markets by issuing bonds. These bonds were bought by institutional investors such as pension funds and insurance companies and will increasingly become sources of funding. Local market bond issues have the advantages of avoiding foreign exchange risk for the institution and of strengthen the local capital market. This funding will be easier in countries with a well develop capital market.   The first steps into securitizing microfinance with private placements and wholesales purchases of microfinance portfolio taking place in Kenya and India. Securitization becomes a standard tool for raising funds in microfinance, help allowing capital to flow from both local and international markets.

+ New kind of products and services: In the years to come, there will be continued efforts to narrow the gap between products and services offered and the one that could best suit to clients' need. The trend is that clients should learn about their needs and express them with

loan officer and MFIs will supply products called a client tailored loans in order to meet clients' demands and MFI loan officers could become financial product advisors. Therefore, the interaction between MFIs staff and clients are the basis laid for product diversification. Parallel to product diversification, the role of providing non-traditional microfinance services continue to increase. There will not be only traditional credit and saving but credit with the introduction of alternative energy sources for example or some new services like foreign exchange transactions, remittance or payment of utility bills.

+ Enhanced use of technology: Technology to transform microfinance already exist. Financial institutions which almost are banks use technologies such as magnetic stripe and chip (smart) cards, credit rating, ATMs, and point-on-sale devices to handle transactions for poor people. These technologies have helped to implement automatic basic transactions, to reduce processing costs and to give customers added convenience. Advance technology such are internet, wireless technology, cellphone network keeps continuing development. It plays more and more important role to achieving the goal of opening access for many excluded people to finance services.

Box 1 : Enhanced use of technology

According to the United Nations International Telecommunications Union (ITU), the number of mobile cellular subscribers worldwide has reached the 4 billion marks by the end of 2008. The number of subscribers has surged nearly 25 per cent annually for the past eight years. Mobile penetration stood at only 12 per cent in 2000, growing to reach over 60 per cent by the end of 2008[3]. Developing nations account for the majority of the mobile phone users although penetration rates vary by region and even within countries. Rapidly developing economies such as Brazil, Russia, India and China are driving the growth in the number of cellular subscribers, with these nations alone accounting for over 1.3 billion of them by the end of 2008

Source: UN news 25 Sept. 2008

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[3] http://portal.unesco.org/ci/en/ev.php-URL_ID=27530&URL_DO=DO_TOPIC&URL_SECTION=201.htm

The wireless access will change not only information flows but also financial service delivery. In the coming wireless world, corner grocers, petrol station and lottery outlets with cell phones can become delivery points/channels for financial and other services. The development of mobile and branchless have gained a lot of advantages. Thank to mobile banking services, people will be able to do their transactions without any physical contact with bank branch or a MF credit office. Besides the benefits of improving access and quality services with clients, technology also showed its potential in MFIs back-offices such as processing, data management, risk analysis system…

1.2   THE IMPORTANCE OF RESEARCH ON MICROFINANCE

As the developing country with approximate 73% of the population living in rural areas and about 54% of the national workforce working in agriculture, around 80-90% of Vietnam's poor live in rural areas and around 20% of the rural population has access to any kind of institutional finance sources. When microfinance was popular in the world and took a lot of attention of international development agencies as the important tool for poverty alleviation, Vietnam kept pace with new chances of this emerging finance industry. With the recognition about microfinance importance in economic as well as social well-fare development, the Vietnam Government identified improving microfinance industry to ensure that the rural poor have access to credit and financial services as one of the most tangible ways to assist low-income households out of poverty and build national inclusive financial section. It has become a key goal in long term to obtain gender quality, sustained growth, economic and social development. Since then, remarkable progress has been achieved. Vietnam's Government positive movements to support the development of microfinance industry led to the issuance of

a new law on microfinance in March 2005 that allow independence to microfinance institutions to be established. There was also an official commitment in the National Socio-Economic Development Plan from 2011 to 2015, that sustainable economic growth must be coupled with social development and microfinance which aimed at ensuring rural households having access to financial services is considered as the most important component of the Governmental Economic Development.

The DFC Group report to the WB, *Developing a Comprehensive Strategy to Expand Access to Microfinance Services* (Volume I, The Microfinance Landscape in Viet Nam – February 2007), documents the rapid growth in Viet Nam's financial sector and with it the coverage of low income and poor people ("outreach") by microfinance institutions. It estimates that between 70-80% of the poor might be able to access some form of financial service, mostly in the form of short-term credit and savings, and that the formal banking system appears to reach a substantial number of them. With progresses in dramatically poverty reduction, Vietnam was reached its Millennium Goal in 2015[4] and has transformed from one of the poorest countries to lower middle-income country. Notwithstanding past achievement, the poverty agenda still needs attention. Poverty was different between rural and urban areas, economic regions, ethnic groups, education and gender. Poverty gains are fragile, significant share of the population is still vulnerable, living close to the poverty line (one third of the population-equivalent to about 30 million people fall into the poor or near poor groups[5]). Poverty was reduced in a much slower pace in the central region, the extreme poor still concentrated in northern mountain and north central coast, belong to the ethnic minorities. The latter are highly vulnerable to shocks from climate changes, natural disasters as well as

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[4]Source: http://vietnamese Government Web Portal); Vietnam and World Economies 2009-2010. Vietnam Economic News

[5] http://www.worldbank.org/en/country/vietnam/overview

economic and health shocks. The DFC Group/WB study report (Volume I – 2006) also characterized microfinance industry in Vietnam by its *"fragmentation, lack of regulation and a degree of inefficiency that raise questions about its sustainability, about its path of future development and its integration within the financial sector."* Its second volume report goes on to suggest that the national strategy for increased access to microfinance services for the poor needs to emphasize not so much outreach but rather the efficiency and sustainability of the institutions that comprise the microfinance industry and serve the poor

In Vietnam, there were three groups that provided microfinance services: formal financial institutions; semi-formal groups including social organizations and international organizations; and informal providers including moneylenders and savings collectors who operate in black market without controlling of the Government. The Government's multi-pronged approach of modernizing agriculture, promoting non-farm household businesses and increasing opportunities for SMEs growth gave momentums for Vietnam microfinance institutions rapid development. Although in Vietnam there still existed informal providers including usurers and savings collectors, their market shares have declined and replaced by the network of the formal providers who had a growing extensive geographic presence to cover low-income rural households

Box 2: Decline in Informal and Semi-Formal Credit

The share of informal and semi-formal mechanisms as a source of credit has gradually declined during the last 10 years, in favor of the formal sector. For instance, VBARD which was established with the first financial function of providing directly financial services to rural households in agriculture, forestry and fisheries sector is now responsible for a majority of the loans in rural market. In 2004, VBARD's outstanding loans to farm households accounted for 58% of the bank's total gross loan portfolio. A two-round survey of farm households was conducted by Hanoi Agricultural University and the University of Sydney in four provinces: HaTay and YenBai in the North, and BinhDuong and CanTho in the South with roughly 400 interviewed farm households in 16 communes, from two districts in each province. Almost two

thirds of them had a loan, with formal credit institutions accounting for the bulk of them. On average, about 30% of households had borrowed from VBARD, with the share being much higher in CanTho.

This was not always so: data from the 1993 Vietnam Living Standards Survey (VLSS) shows that 40 percent of loans in rural areas were from private individuals, 33 percent from private money lenders, and 25 percent from banks and other formal sources.

Source: Vietnam Development Report, 2006.

Now in formal section, Vietnam has a wholly State-owned non-profit entity that is Vietnam Bank for Social Policies (VBSP) focused on subsidized "social policy lending" to poor households and disadvantaged groups as defined by Government. Besides, there are two big state banks namely Vietnam Bank for Agriculture and Rural Development (VBARD) and Co-operative Bank (Co-op Bank) together with People Credit Funds network providing credits, saving and some other financial products to the poor households in rural areas with commercial market-orientation. From 1990s through 2005 some 40 semi-formal MFIs were formed mainly through the Credit and Savings Program or by Mass Organizations (MO) and Non-Governmental Organizations (NGOs) while another 10 MO/NGO-MFIs were formed thereafter.[6] However, the dominant roles in microfinance market belong to VBARD and VBSP. VBARD has the most extensive network, reaching some 5 million clients with average loan sized USD405. It lends up to USD 625, primarily to farmers without formal collateral if the loan applications are backed by mass organizations that co-service loans. The bank also serves as a distributor for Vietnam Bank for Social Policy. The VBSP follows the type of Grameen Bank which is the bank for only the poor. However, it is supervised by the State Bank of Vietnam and exempted from tax and deposit insurance. It took over numbers of national lending programs previously managed by the Ministry of Agriculture and Rural Development and Ministry of Labor, Invalids and Social Affairs. The bank now lends to

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[6]Data is from ADB's microfinance assessment research to Vietnam State Bank in November, 2010

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individuals rather than enterprises on the average loan size of USD125. Loans are usually backed by either the local authority or mass organizations that co-service the loan. The VBSP offer below-market interest rates (typically 6% per annum), therefore, in fact, it is the bank which influenced mostly on the market and defines lending policies. Vietnamese Government's subsidy approach and limitations in operation process of microfinance institutions have raised concerns from financial researchers about sustainability of Vietnam microfinance institutions. Constraints on microfinance operation in Vietnam can be listed as follows:

+ Policy makers have long regarded microfinance as a charitable activity, instead of being a part of the finance industry. Some of MFIs still have many part-time and are slow in professionalizing their operations, their leading boards even lack of knowledge on banking, accounting management.

+ The formal financial sector still not provide sustainable and widespread access to microfinance service particularly in remote mountainous areas. Thus, there are still a large number of extreme poor households in Vietnam that haven't had access to formal credit sources.

+ Another factor that has hindered the development of microfinance services in Vietnam was the lack of data about the local microfinance market and lack of innovations in microfinance activities in accordance with international best practices.

+Most MFI have very weak MIS and internal control.

+In terms of financial viability, MFIs are constrained by interest cap, coupled with the limitation of capital fund for expansion. Although MFIs have flourished in both social and commercial terms all over the country, few are profitable

All these matters show that Vietnamese microfinance industry is still in infancy and concerns for long-term sustainable development can't be overemphasized. Indeed, the importance of sustainability in long livelihood of MFIs has mentioned many times in literatures. It is argued that "unstainable MFIs might help the poor now, but they will not help the poor in the future because the MFIs will be gone" (Schreiner, 2000) or it may be better not to have MFIs than having unstainable ones (Adam et al, 1984) because unstainable MFIs might hurt exactly those whom they are meant to help. Therefore, studying strategic factors affecting development of microfinance institutions in Vietnam and how MFI can get financially sustainable becomes imperative and has constructive meaning in suggesting some suitable solutions for the national inclusive financial strategy.

1.2   RESEARCH QUESTIONS

The current microfinance situation in Vietnam as stated above has raised the following questions for research:

1. What are the key factors affecting the development and management of microfinance in Vietnam?

2. How can measure the effects of those factors on the micro finance sector?

3. How international experiences in microfinance development can be applied in Vietnam?

4. In future, what is the tendency of the sustainable development of Microfinance in Vietnam?

5. What the Government should do to improve the landscape of microfinance? What is the favorable legal network for this young industry?

1.4   GOALS OF THE THESIS

My research idea originated from the Government's contention of building a safe and developing microfinance system and integrating microfinance fully with the national finance

sector. The study topic was: ***Factors affecting microfinance development in Vietnam.*** The development of a microfinance system could be understood as the sustainability of microfinance industry and the permanent operation of microfinance institutions which are needed to conduct microfinance activities, provide microfinance products and services to the unbanked poor clients. Literature shows that microfinance institutions are sustainable if they can maintain a proportional balance between profitability in the long term, the supply of products and services for the clients' benefits as well as social benefits to communities. In other words, the sustainability of MFIs will depend largely on their capacity of finance and innovation as well as the environment in which they operate. With that point of view, the study aimed at two specific objectives: assessing the sustainability of financial innovations and operating environment by comparison with successful benchmarks in the world; and then determining factors affecting the financial sustainability of microfinance institutions. Specific goals of the study and methodology approaches can be outlined in following table

Table 2 : Goals and methodology of the thesis

ThesisGoal(s)	• Analysis of Factors affecting to the development of microfinance in Vietnam
Focus of the Assignment - Key Areas	• The current Vietnam microfinance active ities and microfinance location in the whole picture of the national socio-economic development. • Innovation sustainability Vietnam microfinance institutions in comparison with some other international successful benchmarks • Factors affecting Financial sustainability of microfinance institutions

Objectives	Works to achieve the outcomes
1.Evaluation of Vietnam microfinance progress and its location in the national socio-economic development	Participatory and secondary data and literature review will be used to carry out qualitative researches, including: • Overview the country financial system • The historical development of microfinance in Vietnam • Assessment of microfinance activities and its role in expanding the national financial system.
2.Assess innovation of Vietnam's microfinance institutions in development process	The participatory and secondary data and literature review will be used to carry out the following proposed activities, including: • Case studies about the successful innovation of Grameen Bank, Bangladesh and Bank Rakyat, Indonesia. • Comparative analysis of financial innovations between Vietnam microfinance system with the two above-mentioned benchmarks.
3. Assess factors affecting the financial sustainability of microfinance institutions.	Empirical research is reviewed and data are collected A quantitative approach is used to study the determinants of financial sustainability of MFIs in Vietnam through the estimation of multiple regression models.
4. Propose suitable suggestions for MFIs development and building a financial system inclusive in Vietnam	The participatory and secondary data and literature review approaches are used to carry out the following proposed activities, including: • Major results of research • Policy recommandationls.

Objectives	Works to achieve the outcomes

1.5   THESIS STRUCTURE

The thesis is divided into six main chapters including this introductory chapter. This first chapter presents, firstly, a brief introduction on microfinance, microfinance benefits and trends, and secondly the, goals and methodology of the thesis. Chapter 2 deals with theoretical issues surrounding microfinance including a broad concept of microfinance, microfinance institutions, microfinance approaches, the international rules and regulations on sustainability and financial sustainability of MFIs. Chapter 2 also presents a review of Vietnamese researches about microfinance subjects. Chapter 3 provides an overview on the social economic and legal environment of Vietnam, the main MFI providers. The chapter analyzes the situation of the MFIs operations, their characteristics, evaluates the achievements and weaknesses of Vietnam's MFIs during the sustainable development progress. Chapter 4presents the experiences of the two- large world's sustainable microfinance institutions and makes a comparative analysis between these experiences and Vietnam microfinance system to assess similarities and differences, and to draw lessons. Chapter 5 focuses on the MFIs' performance and assesses the determinants factors through empirical regressive models with both external and internal causal factors. The detail structure of thesis is arranged as follows:

Chapter 1: General Introduction and problem statement
Chapter 2: Literature Review
Chapter 3: Overview on financial system and microfinance activities in Vietnam

Chapter 4: Comparative Analysis of innovation between Microfinance system in Vietnam and other international benchmarks

Chapter 5: Factors affecting the financial sustainability of Microfinance Institutions in Vietnam

Chapter 6: Conclusion and Proposals

1.6   SIGNIFICANCE OF THE THESIS

In its efforts to analyze the causes and effects of Vietnam microfinance development, the thesis aims at contributing to seeking answers to the research questions mentioned above, as well as providing some suitable suggestions for the national policy makers to develop a strategy for an inclusive economy in which microfinance is a part of the national financial system.

The thesis is the first study in Vietnam research literature in the field which has used comprehensive estimation techniques, i.e. time fixed effect static model and GMM dynamic model to test financial performance indicators in uncovering determinants of microfinance profitability.

Empirical results provide evidence that profitability of microfinance institutions in Vietnam is affected by institution-specific factors and macroeconomic, control variables that are not the direct result of institution-managerial decisions. In this perspective, the research approach of the thesis has been organized to provide a tool for exploring profitability determinants. Therefore, at a policy level, the results of this thesis can contribute to define optimal policies for institutional management of microfinance. The results of the thesis provide also some indications on the ways to define credit market policy with the goal of improving the poor's access to finance services

CHAPTER 2: LITERATURE REVIEW

2.0   INTRODUCTION

In this chapter, we systemized theoretical issues surrounding microfinance including a broad concept of microfinance, microfinance institutions, microfinance approaches, the international rules and regulations on sustainability and financial sustainability of MFIs and reviewed Vietnamese researches about microfinance subjects.

2.1   CONCEPT OF MICROFINANCE, MICROFINANCE INSTITUTIONS

While it is commonly agreed that demand for microfinance services is large and though the term "Microfinance" has been used widely but it seems that there is not a common view in the definition of microfinance. The main difference among definitions is about the range of services and target clients. The Asian Development Bank (ADB) defined microfinance in 2000 as "the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to the poor and low-income households and their micro-enterprises". It is noted that ADB's definition of microfinance includes micro-enterprises, low-income households as well as those below the poverty line.

The Consultative Group to Assist the Poor (CGAP) website defines microfinance as "providing very poor families with very small loans (micro-credit) to help them engage in productive activities or grow their tiny businesses". They however also indicate that over time, microfinance has come to include a broader range of services (credit, saving, insurance, etc.) as it has been realized that the poor and the poorest are those who lack access to traditional formal financial institutions and require a variety of financial products. According to the CGAP

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definition, traditionally microfinance was focused on providing a very standardized credit product to only the poor and the poorest but not specifically the low- income households and their microenterprises.

Researchers such as Kyerboah-Coleman and Osei (2008), Schreiner 2000, Legerwood (1999) shared the view that: Microfinance is the provision of small scale financial services such as deposits, loans, payment services, money transfers and insurance to low income or un-bankable people. Legerwood, J. (1999) even broadened microfinance as an economic development approach intended to benefit low-income women and men (i.e. in some sense: the low–income households). In term of financial intermediation, Legerwood further emphasized that many MFIs not only offer financial services but also provide social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Thus, the definition of microfinance includes both financial intermediation and social intermediation. With that definition, microfinance is not simply banking but a development tool.

United Nations Capital Development Fund (UNCDF) defines microfinance as another segment of the market for financial services.

In Vietnam, until now in any official legal documents, people use the term of small-scale finance instead of microfinance to refer the provision of small scale and simple financial services and banking products for low-income households and/or individuals particularly poor households and extremely poor. (Decree 28/2005/ND-CP)

Though there is somewhat different in the definitions of microfinance, its shows a comprehensive picture of the microfinance industry around the world. Before the poor rarely accessed services through the formal financial sector. They addressed their need for financial

services through a variety of financial relationships, mostly informal. Credit was available from informal trade suppliers, money-lenders but usually at a very high cost to borrowers. Savings services were available through a variety of informal relationships like savings clubs, rotating savings and credit associations, and mutual insurance societies that have a tendency to be erratic and insecure. People living in poverty, like everyone else, needed a diverse range of financial instruments to run their businesses, build assets, stabilize consumption, and shield themselves against risks. Financial services needed by the poor include not only basic financial services such as savings and loans, but also current accounts, bill payment services, pensions, insurance, money transfer. Moreover, we have been recognizing the role of various kind of non–financial services and technical consultancy both pre and post the provision of credit service is very important to ensure that the provision of credit service is success to the poor and the poorest. Thus, a broadening of the concept of microfinance should be necessary and our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products. From that point of view, microfinance can be understood generally as a method of developing the economy through the provision of small-scale financial services (credit, saving, credit card, insurance, payments and other financial services), as well as non-financial services such as: business & enterprise development, social intermediation services, social intermediation, and social services to low-income men and women to assist them in meeting their cost of living and investing in their business. A broad definition therefore specifies that microfinance is not only finance but also non-finance as a development instrument.

Institutions that provide these small financial services are known as microfinance institutions (MFIs) or microfinance organizations. They are banks, financial cooperatives and small-scale financial institutions (both formal and semi-formal) that provide microfinance services.

Microfinance institutions are considered as a tool for poverty alleviation through improving access to finance and financial services. MFIs have helped the poor to increase buying and investing capacity, alleviating micro business funding constraint and uplift them on to a higher economic status. They also frequently provide social and business development services such as literacy training, education on health issues, training on financial management or accounting. According to literatures, these benefits of microfinance can only be realized as long as the poor continue to be clients of microfinance institutions (Ahlin and Jiang 2008). Thus, it is important that microfinance institutions should find the way to further enabling even the average borrower to graduate from continual dependence on them to enhance long run development. This will enable MFIs close to the goal of anti-poverty at the same time with sustainable development. Types of MFIs are classified differentially in microfinance literature discussion according to their intended missions and objectives, organizational size, services provided, ownership of equity/funding sources, regulatory status and decision making

Table 3: Types of MFI

Regulated	Banks, regulated non-bank financial intermediaries, regulated NGOs
Cooperatives	Financial cooperatives and credit unions
Unregulated	NGOs, non-bank financial intermediaries, MFI projects and others

Sources: Lafourcade et al. (2005); Shaven Widin Bongasu (2015)

Table 4 : Classification of MFIs

Category A	Type 1	Simple non-profit NGO
(fund resources depend on external donors)	Type 2	Non-profit NGO associated with limited deposit-taking
	Type 3	Incorporated MFI (transformed NGO)
Category B (fund resources come from their business activities)	Type 4	Credit Union, Savings and Credit Cooperatives Society

Category C (fund resources depend heavily on public resource)	Type 5	Specialized Bank, Deposit-taking Institution or Finance Company
	Type 6	Mutual Ownership Bank (licensed)
	Type 7	Equity Bank (licensed)

Source: Van Greuning et al (1999), Shaven Widin Bongasu (2015)

The international conception which defined microfinance organizations are small-scale financial institutions providing microfinance services to the poor goes in line with the Vietnam's Decree 28/2005/ND-CP. It is stated in the Decree that: "Small-scale finance Institution is the financial institutions operating in finance-banking field with the main functions of utilizing its equity, lending funds and deposits to provide simple and small-scale finance banking services and/or products for low-income individual and /or household". The Vietnam Law on Credit Institution 2010 allowed to broaden operation area of MFIs to serve small-size enterprises, stated that MFIs are "types of credit institutions that mainly conduct banking operations to meet the need of low-income individuals and households and super small-size enterprises". Under the Decision No. 2195/QD-TTg dated 6/12/2011 of the Prime Minister approving the Scheme on building and developing the microfinance system in Vietnam through 2020, MFIs can be allowed to label as an official MFI only if they are licensed by the Vietnamese State Bank (SBV).

2.2   THEORIES ON MICROFINANCE

Scholar interests in microfinance have lagged behind its development. Many microfinance institutions have successfully extended unsecure d small loans to poor and opaque borrowers at the bottom of the economic pyramid while that was the failure of traditional banks. To explain for the success of this infancy industry, many important economic theories are used. Theories of asymmetric information and economies of scale have explained us that formal financial

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institutions are reluctant to provide microfinance services. The theory of group lending with joint liability, which originally is a method of lending but presently developed as a theory in microfinance, explains Microfinance Institutions can avoid the above stated problem by creating financial contracts that impose joint liability and create dynamic incentives to mitigate the effects of asymmetric information. The law of diminishing returns shows how microfinance services can be profitable thanks to the fact that the poor businesses can pay high interest rates and why microfinance institutions can charge those high rates to the poor.

Theory on asymmetric information developed by the three US economists who won 2001 Nobel Prize in Economic implied the simple fact that two sides in a transaction do not have the same information. One of the most vital tasks of the bank is to ensure about the repayment probability of borrowers to protect its depositors and shareholders against risks. Therefore, the banks need to use information effectively to solve the three economic problems: What kind of loan contract to provide, to whom and what interest rate. The bank required significant expenses to gather, processing and storing information on borrowers. Asymmetric information in credit market can lead to adverse selection and moral hazard, which can be source of credit risk and be the main concerns of any bank.

Adverse selection arises because the bank cannot perfectly observe the characteristic of borrowers. They give the same treatments to the risky borrower and the safe ones. So when the screening mechanisms cannot effectively distinguish, the standard solutions for bank are to demand collateral in order to ensure that only safe types enter the market. However, typical microfinance clients are the poor; they don't possess sufficient wealth for collateral under the bank's regulation. Therefore, they are denied accessing to the credit services.

Moral hazard arrives after the transaction when the borrowers may deviate from the terms of the loan contract or actually use the loan for other purposes. One solution for the bank is to have to monitor the borrower's actions after giving loan, and this approach is costly. The bank, therefore, try to demand collateral as a mean of mitigating the problem of moral hazard. Once again, poor borrowers are excluded from the market because of asymmetric information problems.

Theories on economies of scale: implies lower average cost as the result of mass producing a good. In finance, it can be understood as both when loans are large and when the number of borrowers increases, the average lending cost decreases. This theory in one side encourages lender to make large loans rather than a number of small loans to reduce cost. In the other side, it suggests that if lenders can make some loans in the same ways, the average transaction fixed cost also decreases. Therefore, to expand quickly and keep the costs of handling each loan application low, financial institutions may offer simplified and standardized loan contracts but by so doing can lead to a fall -off in portfolio quality because of economizing on the resources needed to select the best potential borrower. To find out the solution, financial institutions have been interested in finding new lending methodologies to the economies of scale and increase the quality of borrower such as making use of advantage of new lending technologies such as Group Lending Methodology.

Group lending with joint liability: In the late 1970s. the success of Grameen Bank introduced a practical solution for the problem of adverse selection and moral hazard: that is group lending with joint liability which is now known as a theory of social liability or peer lending. Indeed, the solution is the idea that instead of offering individual liability contracts, the bank lends to a group of borrowers who are jointly liable for each other's loan. So, if one member of the group default on his debts, other members in the group must repay the bank a portion of the defaulting member's loan in addition to their own liabilities. The group loan
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contract differs from an individual loan contract in that group members are now liable for their fellow member's loan. Therefore, safe borrowers will not wish to match with risky types since the latter are more likely default on their loan, leading a higher expected joint liability cost. Group lending with joint liability overcomes the problem of moral hazard by passing the monitoring activity onto the borrowers themselves. They will monitor their peer and pressure those individuals who misuse their loan to act accordingly. Since group members will typically know each other well in advance of the date of borrowing, so their information for each other can be available they will save the expense less than it would be for the lender and increase the quality of borrower. Moreover, when financial institutions made loan to the group, the fixed cost transaction would be lower than if they made individual loans.

The Law of diminishing return and profitable microfinance: In economics, diminishing return law plays an important role in explaining a firm's behavior. It states that if other factors are fixed in supply and successive units of a variable factor are added to them, then the extra output derived from the employment of each successive unit of the variable factor must, after a time, decline though they may increase prior to that and this may hold for revenue as well as output. In finance, the law of diminishing return can be expressed as when more capital is added, the marginal return tends to increase to a point beyond which any additional capital could lead to a lower marginal return. Applying this theory into microfinance can lead to a belief that small businesses seem to have higher marginal return than large businesses because they lack access to capital and any additional capital could be in the first stage of increasing marginal return, while large businesses seem to be in the second stage of decreasing marginal return

As stated above, due to the high transaction cost, the expense against high risk due to imperfect information and moral hazard, Microfinance institution tends to charge their interest rate much

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more than the rates that commercial banks charge to the usual customers. But infact, that the poor can enjoy their investment opportunities and they can earn profit thanks to the law of diminishing return and they are willing to repay their loan with high interest rates. Therefore, microfinance Institutions can expect a profitable and sustainable development by meeting their high cost by charging high interest rate.

2.3   MICROFINANCE APPROACH

As stated above, Microfinance Institutions are considered to be tools for poverty alleviation through improving access to finance and financial services for the poor. This function of MFIs helps poor households to create their income generating capacity to get out of multifaceted dimension of poverty and reduce their vulnerability to unexpected events. Thus, the contribution of microfinance to this end has been measured through what is known as microfinance outreach that is the capacity of an MFI to reach the poorer of the economically active poor. Besides MFIs need to gain financial sustainability through its effective operations in order to create profits to cover its expenses and develop in long term. The two goals of microfinance in providing financial services to the poor: for poverty reduction and for profit, result in two different approaches in microfinance, which are mentioned in literature as the poverty reduction approach and the financial systems approach (Robinson, 2001).

Poverty reduction approach is the approach of welfarists which consider microfinance as a tool for poverty alleviation. This approach measures the poverty lending by depth of outreach. That is, it focuses on not just large number of clients (breadth of outreach) but large number of poor clients (depth of outreach) This approach claims that there is no need to discuss financial sustainability if services provided do not have any impact on client's poverty level. It

concentrates on reducing poverty through subsidized credit with donor and government support or social investors (Robinson 2001, Woller and al 1999) Taking the view of welfarists, many organizations especially NGOs argue that there is a trade-off between sustainability (profitability) and targeting the poor (outreach) because the poorest are cost ineffective to reach when profitability is considered and thus donor support is required to this end. Most MFIs that provide subsidized credit have failed to meet the excessive demand for financial services from the poor household in terms of both outreach and financial self-sufficient. Moreover, for the extremely poor household because of lacking profitable self-employment and high risks involving in using loan they may not be able to use the loan effectively (Robinson 2001) and thus credit may be even harmful for them. Indeed, if there exist some productive opportunities, financial services can help poor households get out of poverty (Gonzaler Vega, 2003) and assist in stabilizing income and eliminating vulnerability to risk (Zeller and Meyer, 2002, 2003) but if productive opportunities do not exist, repayment capacity will usually be missing and enforcement of debt contracts will impoverish borrowers.

Financial systems approach is developed by institutions, which focus mainly on financial sustainability of microfinance institutions to create sustainable financial intermediation for the poor. Institutions argue that in most cases, donor dependence is not certain; microfinance must be able to sustain itself financially to serve the poor in long run. The financial sustainability is measured by financial self-sufficiency (profitability) of institutions. The most important feature in financial system approach is that it focuses on applying the principles of commercial finance into knowledge of microfinance market, then constitutes the term commercial microfinance. The essential and expected goal of commercialization of microfinance is to attain a sustainable microfinance which comprises of both institutional sustainability (wider outreach) and financial self-sufficiency.

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 Another important feature of financial systems approach is that it considers the sustainable provision of financial services to the low- income households who can make use of financial services, but not necessarily the poorest of the poor. Institutions argue that given enabling macroeconomic, political, legal and demographic conditions, financial institutions can be developed to provide sustainable financial intermediation for the economically active poor and low- income households at the local level profitably without subsidy and with wide coverage, by doing so, the financial systems approach aims at achieving large scale outreach with broader range of services including credit, saving and other (Robinson 2001). The financial system approach's goal of sustainable microfinance is reached by delivering financial services at interest rates that enable them to cover all costs and risks and to generate profit. To make the financial system approach viable, it requires commitments by governments to financial market liberalization, reducing targeting loan and better pricing of financial products. However, over emphasis on financial self-sustainability may lead an MFI into moving away from its poverty reduction objective (Stack and Thys, 2000). This is known as mission drift. (Aubert et al 2009)

Like other developing countries, Vietnam is following the traditional poverty reduction approach providing microcredit programs for the poor through mass organizations and the state development banks, especially in agriculture and rural development. However, the Vietnam Government is now seeking to lighten its subsidy burden and so a shift toward market-based provision of microfinance through independent NGOs is underway (ADB report, 2008). It is the true that microfinance can be profitable and following financial system approach is the right way, to enable the development of sustainable microfinance. However, if microfinance institution only focuses on profitability and better-off poor client, the poorest of the poor are left aside and the social objectives of microfinance will be disappeared. There should be a

balance between a social and commercial goal to support the development of the microfinance industry.

2.4   MICROFINANCE LITERATURE REVIEW

Microfinance is a hot topic in current development debates although it has long history. A great deal of attention and funding has been directed toward microfinance over the past few decades. Scholar interests in microfinance lagged behind the development of microfinance industry. The development of MFI is the pre-conditions for them to complete their important goals. However, the factors determining the development of microfinance sectors in are not clearly known because development can be measured in different ways basing on MFIs' specific characteristics and their objectives

MFI are considered developed if they contribute to both economic development and poverty reduction, that made the main difference between MFIs and commercial banks. While commercial banks try to achieve sustainability before expanding access even when they are still young, MFIs focus on their first goals of depth and width access right from its establishment and then their operation, financial and institutional sustainability. (Nguyen Kim Anh et al, 2014, Nghiem Hong Son 2006)

Chart 1: Development process of MFIs
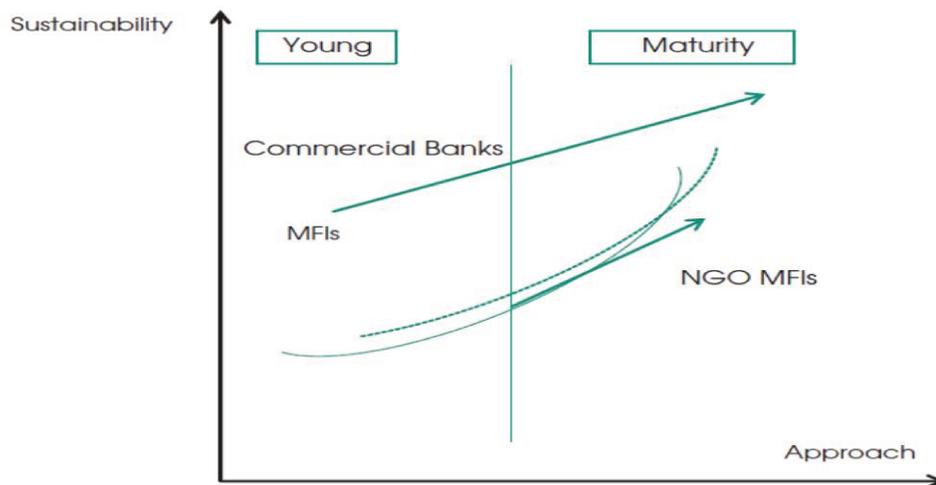
Source: Nghiem Hong Son (2006)

For development, it is often mentioned in literature that MFIs have to face double challenges: not only do they have to provide financial and services to the poor (outreach) but they also have to cover their costs to avoid bankruptcy (Giovany Ferro-Luzzi and Sylvain Weber, July 2006- Measuring the performance of Microfinance Institutions). Hartarska and Nadolnyak, 2007 also emphasized that the objective of MFIs is generally seen as a double one: to reach the financially excluded poor and to become financially sustainable for being independent from donor subsidies. The focus of existing studies on MFIs' development so far can be divided into three broad categories: (a) the analysis of MFI specific determinants of performance such as contract design, lending methodology and corporate governance; (b) macroeconomic factors determining the uneven distribution of MFIs and the impact of country-level aggregates such as growth, inflation, poverty and corruption; and (c) the analysis of macro-institutional determinants of MFIs' success by disentangling the impact of MFI sustainability factors and the external environment they operate in[7]. Recently, the transformation of MFIs into commercial entities has also increasingly received attention. All studies have theoretical and

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[7] Dr. Nargiza Maksudova, CERGE-EI- Macroeconomics of microfinance: How do the channels work- CERGE-EI Prague, October 2000.

practical meaning to affirm the role of microfinance in respond to the need that bank couldn't fulfill and flourish where formal banking sector fails as well as support for the integration of microfinance into the national inclusive financial system.

Sustainability in MFIs, which refers to the ability of microfinance institutions to cover their operating costs using operating revenue generated from their core activities (Woller et al, 1999; Ledgerwood, 1999) and its determinants are also main subjects of researchers. MFIs' sustainability could be considered as a mean to ensure the development of microfinance industry. It is argued that the sustainability of MFIs depends on the country-level context because their performances are non-negligibly influenced by the macroeconomic and macro-institutional environment in which they are situated. Accounting for context allows a clearer picture of institutional success and failure to emerge (C. Ahlin et al, 2010). Empirical researchers as Vanroose 2008, 2009 and Christan Ahlin et al 2010, S Katshuri Imai, 2009, 2010, 2011…, are pioneers focused on studying the link between macroeconomic factors such as economic growth, inflation, poverty, corruption and microfinance operation and their important research conclusions demonstrate positive correlation between economic growth and MFI financial performance. Campbell N.D and M. Rogers in 2012 examined the determinants of return on equity for MFIs. The research indicated that MFIs begun to look to the capital markets as a source of fun to meet their objective of being financial sustainable without relying on external funding. Research finding also confirmed that macroeconomic conditions affect MFI return.

Almost empirical researches about determinants of MFIs' sustainability are used regression model with cross-country data. There are a few studies on developing countries with particular economy and political structure but their results are different. Kindle, B. A. (2012) identified factors affecting to financial sustainability in Ethiopia including microfinance

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breadth of outreach, depth of outreach, dependency ratio and cost per borrower. Chijoriga M.M (2000) evaluated the performance and financial sustainability of Tanzanian MFIs in terms of the overall institutional and organizational strength, client outreach and operational and financial performance. Finding shows that numbers of branches in almost regions of the nation, loan repayment rate and capital structs are main factors giving effect of financial performance of MFIs…Each country has their own microfinance characteristic as well as different macroeconomic environments so effects of these factors to MFIs' sustainability are various. This thesis with the topic of analysis of factors affecting to development of microfinance in Vietnam case will help contribution to literature on this field.

2.5   VIETNAM'S RESEARCH ON MICROFINANCE

In Vietnam, since the success of 1986 economic reform, the nation has transformed from the central planning to a market oriented economy (Dao Hung 2001, 2002) and gained major achievement in terms of economic growth and poverty reduction. Rural development and agriculture are considered as a priory goal in the national development strategy and microfinance is considered as the most important component of the strategy aiming at ensuring rural households having access to financial services (SRV 2002). As a powerful mean of poverty elimination, the growth of microfinance in Vietnam has become more and more rapid and drew attentions of both local and foreigner researchers. Most research efforts have mainly focused on analysis of microfinance market to understand the industry's characteristics, highlight challenges and constraints for future development; analysis the needs of microfinance schemes at the local level, credit rationing; assess impacts and efficiency of microfinance scheme on poverty alleviation, households'wellfare.

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Piere Fallavier is one of the first foreign researchers who are interested with microfinance in Vietnam. The American came to Vietnam to do field trip study in the poorest regions for his thesis in 1994. Through extensive literature review and participation in field interviewing, the author analyzed Vietnam's microfinance in terms of the characteristic and' the environments that MFIs evolve in and tried to identify indicators of the effectiveness of MFIs in empowering people out of poverty. His analysis concluded with a relatively positive impression that Vietnam has potential to develop an efficient infrastructure of MFIs that would deliver adapted services to the poor on financially sustainable basis and enable them to re-integrate the productive fabric of the society. For that purpose, he suggested Vietnam's microfinance strategy should be re-oriented to promote the creation or formalization of MFIs and allowed them to operate on a market-pricing base. The study contributed to help Vietnamese regulators draw out policy directions for the development of the microfinance. Besides independent researchers, there are many international projects of technical assistance from World Bank, ADB, ILO to support the country develop the young microfinance industry in Vietnam. For example, the World Bank's report of " Vietnam: Developing a comprehensive Strategy to expand Access (for the Poor) to microfinance services: Promoting outreach, efficiency and Sustainability.." in Feb. 2007 showed out their overall assessment of Vietnamese microfinance landscape as well as some recommendations for Vietnamese Government in affecting the Decree No. 28/2005 (the regulation permits some NGO organizations can be transformed into formal microfinance institutions) into practice. Adam Carty and his colleague conducted a survey of scheme and issues in April, 2001 assessed micro-financial schemes operated by NGO microfinance institutions through indicators of outreach, customers' satisfaction and the different of cost fees between formal and semi-formal microfinance sector. The survey is conducted base on 84 schemes in operations throughout Vietnam and found that

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microfinance Vietnam is a repressed microfinance systerm where goverment set up the interest rate and it is the level below that market demand and supply would otherwise decide. A repressed finance systerm leads to the segmentation in Vietnam microfinance sectors which remains dominated by the two big state banks: Vietnam Bank for Agriculture and Rural development and Vietnam Bank for Social and Policy. Solutions for that is Vietnamese Goverment should develop a market-based microfinance and encourage microfinance institutions to be self suficiency and sustainable.

The impact of microfinance loans to social welfare and living standard of households in rural areas is also among the most attractive research subjects. Indeed, the poverty reduction by approaching to microfinance with major subsidy from the government has increased the potential access of the rural households in the country to financial services (Dao, 2002, Mc Carty 2001). Cheap credit from governments and donors is provided to the poor in rural area through the network of stated owned banks (SRV, 2002). Many studies were conducted to assess that influences with a lot of different methodologies including experimental quantitative models as well as qualitative approaches. All of them showed the same similar positive results. Dao (2000; 2001b) assessed the socio-economic impact of the rural credit funded by Asia Development Bank and funded by World Bank respectively. The difference in the two projects is the disbursement network of the two credit funds (the first project was disbursed through Vietnam Bank for Agriculture and Rural Development and the rest one added People Credit Funds's network as one more disbursing channel besides VBARD). According to Dao (2001b), more than 90% of interviewed borrowers in research surveys confirmed their income increased after receiving loans to start up or expanse small-scale businesses although even there is still a limitation in the diversity of work to generate income. Loans have been mainly disbursed for livestock and farming activities (Dao, 2001; Nguyen et al 2011). With higher income,

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expenditures for family consumption increased, particularly spending on better schooling. Levels of assets and savings also increased significantly. Another quasi-experimental survey by Swain et al. (2008) to estimate the impact of microfinance on poverty reduction also showed positive beneficial results on poor's living standards. The survey targeted in Mekong Delta area in Vietnam with three groups of research people: successful members (those who successfully escaped from poverty at the time of the research), poor members (members who remain poor), and non-members (who did not join in any microfinance program), covering 134 households in the research area. With approach of participatory rural appraisal (PRA) techniques including group discussions and in-depth interviews, the findings show average income per capita of the member households is up to three times higher than that of non-members. The authors also found that members had accumulated more and better-quality assets than non-members. Not only stop at observation approach which is just observed outcome following programe participation, the above results can be seen through empirical researches. Hao (2005) used data from the Vietnam Living Standard Survey (VLSS) data in 1993 and 1998, in which more than one thousand households were sampled for his econometric model. The author applied probit regression to estimate determinants of credit and the Heckman twostep method to estimate the impact of credit on household welfare. The findings showed that access to formal credit has a positive impact on consumption per capita. Lensink and Pham (2012) used panel data with a sample of about 3,200 households, obtained from VLSS 2002 and 2004 to evaluate the impact of microcredit provided by VBSP on self-employment profits in Vietnam. The findings indicated that microfinance had positive and significant impacts on self-employment profits of the borrowers. More importantly, microfinance had positive impacts on poverty reduction and these impacts were more significant for the poorest households.

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However, while the impact of credit on household poverty reduction is found positive but some small, formal financial sectors have shown itself unsustainable in reaching the poor. There are still many poor households in Vietnam that could not access to formal credit sources even though they have vast demands for using loan capital and they have high repayment capabilities to debts..., they have refused borrowing production capital from the banks (Dr Dao Hung 2000 "Credit Solutions the Poor in Vietnam" and his further research report "Outreach Diagnostic Report: Improving household Access to Formal Financial Service"). In the effort to figure out cause of that problem, Pham and Izumita (2002) assumed an excess demand for credit in the rural market and thus saw credit rationing as a function of access to the market or external credit rationing. They found that reputation, the dependent ratio and the amount of credit demanded are determinants of credit rationing. Their results imply that poorer households are more likely to be rationed. The research conclusion of Pham and Isumita about credit rationing has reminded us to a previous study of the Rural Credit Market in Vietnam" by Tran Tho Dat, 1998. The research used logic model and OLS regression to examine determinants of households access to formal credit in Vietnam. His result showed that farm size, farm size squared, total number of household, the possibility of pledging collateral and social participation have significant impact on the probability of access to formal credit. It means that the poor or extreme poor in rural areas who have no collateral have been objective of credit rationing to become un-bankable. Looking more at several quantitative empirical researchs on Vietnam rural credit which discuss determinants of credit and determinants of credit rationing by authors like Quach Manh Hao 2005, Cuong H Nguyen or Mikkel Barslund and Finn Tarp gave us quite similar answers for who, loans can be appoved. Borrowers are rationed at all level, the amount of credit that they may receive is affected by various factors, of which education, household savings, the availibility of credit and the area devoted to

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farming are important. Lenders likely prefered better off households rather than the really poor, that leads to the unbanking stituation of the very poor in rural areas while they are the most targeted clients in traditional microfinance.

To fulfill the gap of formal bank to provide financial services to the poor, since the early of 1990s, there are the establishment of some government-related institutions such as TYM fund, Women Union's Fund or CEP fund as well as the emerge of some NGO institutions like Save the Children US or the Adventist Development and Relief Agency International (ADRA). These institutions had been grown expansion access rapidly and had been believed to contribute to poverty reduction and the development of microfinance industry (Nghiem 2005). Through a survey of 46 NGO schemes in the north and the central regions of Vietnam, Nghiem et al conducted a research investigating the efficiency of these programs. The authors use data envelopment analysis (DEA) methods to assess the technical efficiency and scale efficiency of microfinance schemes. The empirical results reveal that the average technical efficiency scores of schemes surveyed is 80%. Especially, schemes operate in remote area seem to be more efficient than other schemes.

According to international literatures on microfinance, balancing outreach and sustanabiltiy is the key to success of some big famous microfinance providers (Rhyne 1998, Robinson 2001, Gonzaler Vega 2003). The results encouraged Vietnamese local researchers link performance of Vietnamese microfinance institutions with various factors that could impact the efficient operations and long term operation to figure out the relationship between outreach and performance sustainability. Among studies, there are two authors both chose system of People Credit Funds to study but they used two different econometric models.. People's Credit Fund Systems (PCFs) has demonstrated to be the successful microfinance provider that reaches sustainability while serving the low-income households. However, PCF operations are also

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various, because each PCF is individually independent in term of finance and management. Many PCFs work very sustainably, while few others are in bad conditions. So it is suitable to be chosen to test the relationship between outreach and sustainability. With author Nguyen Thu Hang, the Polanco model is applied for 117 grassroof of PCFs in Thai Binh and Ha Tay provinces in period 2004-2009 to analyze the relations between outreach and FSS (ROA). Finding of the paper confirms about the tradeoff in microfinance performance: outreach has negative relation with FSS in PCF case. However, effect of other factors reduces this negation and help PCF expand outreach to the poor and reach FSS simultaneously. For example loan size relates positively to ROA and negatively to number of borrower. Estimated results suggest that for PCFs reaching sustainability, outreach will be deepened if PCFs increase number of borrower and/or decrease ROA and/or call for aid; for PCF, which has not reached sustainability yet, it should increase margin and/or raise ratio mobilizing on asset and/or put up loan size. Margin (interest policy) is one of the most important policies that PCF should consider. While, Le Thanh Tam (2008) with his Ph. D thesis "Development of Rural Financial Institutions in Vietnam" followed model of Christen (1995) and Thys (2000). The result of empirical econometric test showed the agreement with the hypothesis on complicated relationship between sustainability and outreach.

Although there are several empirical researches, in comparision with other countries, Vietnam has still few of in-depth studies on factors affect to financial performance of institutions. There are not only outreach which has impact on financial sustainability of microfinancial institutions but the others. The hole in Vietnamese literatures on financial performance of microfinance institutions would be a very interesting subjects to explore and indeed, it creates a lot of motivation for the conduction of this thesis.

2.6   CONCEPTION FRAMEWORK

Conceptual framework is the system of concepts, assumptions, expectations, beliefs, and theories that supports and informs us the main objective of the research in visual (Miles & Huberman, 1994; Robson, 2011). It can explain either graphically or in narrative form, the main things to be studied—the key factors, concepts, or variables—and the presumed relationships among them. This study is conducted to analyze factors that affects to the development of microfinance in Vietnam. These could be understood as the sustainability of microfinance industry as well as permanent operation of MFIs which are means to conduct microfinance activities. There are many criteria to evaluate the performance of microfinance industry but the most popular method among analysts called "Critical Microfinance Triangle or Triangle Theory of Microfinance" proposed by Zeller and Mayer (2002).

According to Zeller and Mayer, there are three critical dimensions that should be considered thoroughly in evaluating MFIs' performance: financial sustainability, outreach to the poor and impact on welfare. The inner circle represents MFI innovation in technology, policies, organization and management that affect how well each objective is met. The outer circle represents the environment which broadly affects microfinance performance includes the human and social capital possessed by the poor, the economic policies of the country, the quality of the financial infrastructure that supports financial transactions. Improvements in the environment make it easier for MFIs to reach the three objectives. Basing on Zeller and Meyer's framework, the research will focus on the assessment to the environment in which microfinance operates, the finance innovation of MFIs and factors affecting to the financial performance of MFIs.

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Figure 1: Critical Microfinance Triangle

Human Capital, Policies, and Financial Infrastructure

OUTREACH
TO THE POOR

INSTITUTIONAL
INNOVATIONS

FINANCIAL
SUSTAINABILITY

IMPACT
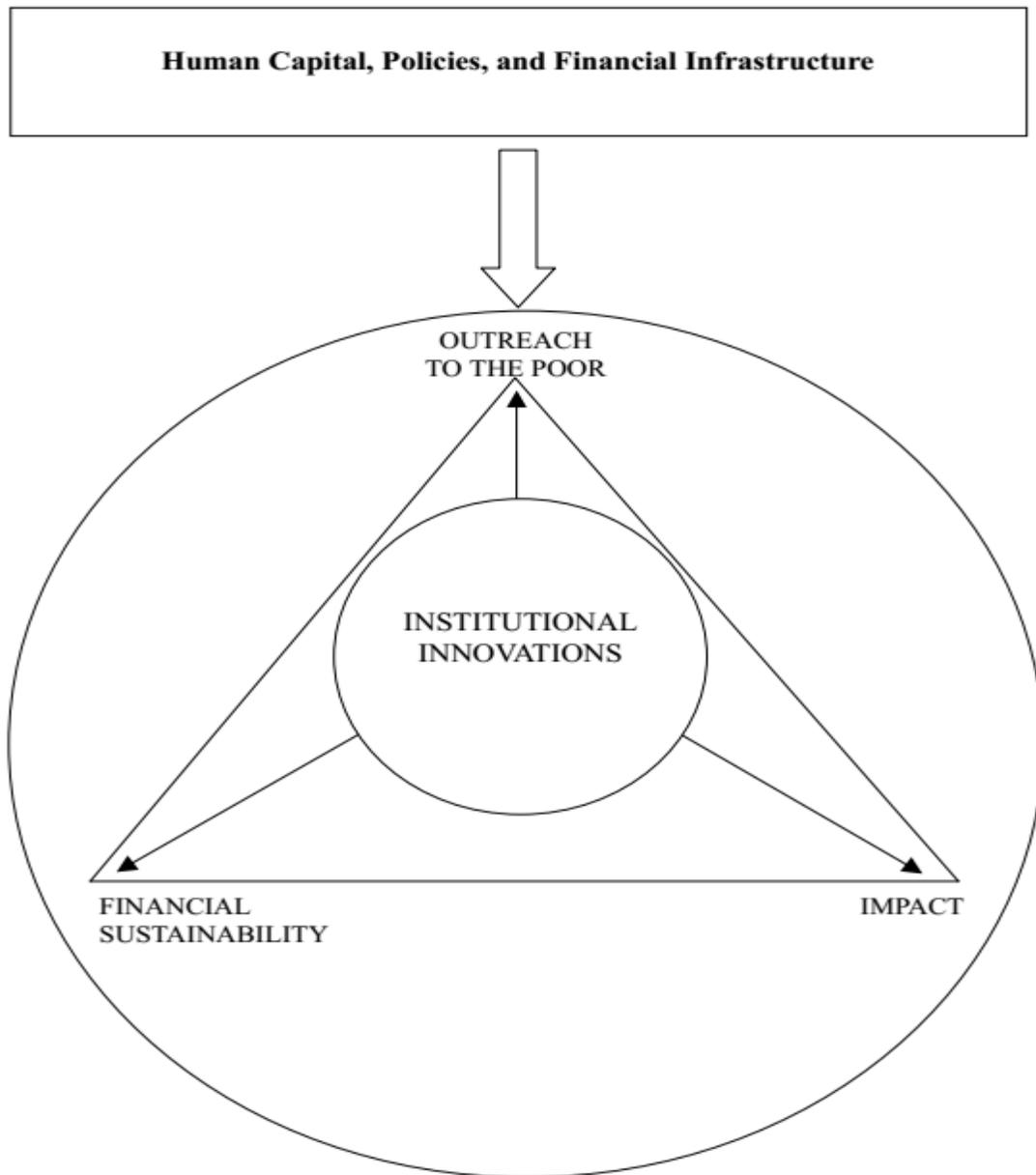
Source: Zeller and Meyer (2002)

2.6.1   Suistanability of microfinance institutions.

Sustainability is equated in microfinance literature and parlance with financial self-efficiency and may be assumed typically link with for-profit commercial organizations. But it is not true, almost two-third of sustainable microfinance institutions are NGOs, cooperatives, public banks or other not-for-profit organizations (Rosenberg et al, 2009). In general, the term "sustainability" is refers to the long-term continuation of the microfinance program after the project activities have been discontinued. It entails that appropriate systems and processes have been put in place that will enable the Microfinance services to be available on a continuous basis and the clients continue to benefit from these services in a routine manner. Sustainability can be viewed from an institutional or project perspective. From institutional perspective, sustainability is taken to mean full cost recovery or profit making and associated with the aim of building microfinance institution that can last into the future and provide services on a long term basis with either its own resources or debts secured from commercial sources which organization must have ability to repay and without perpetually relying on government subsidies or donor funds (Christen 1997, Meyer 2000, CGAP) and from a project perspective, sustainability refer to the life of a project beyond a period during which its finances come from external resources such as donors (Legerwood 1999). These two perspectives have been showed that sustainability is a question of self –reliance in the medium to long-term in which income from microfinance operations/services should be greater than cost of operations or service delivery. Sustainability not only immediately understood as financial terms or resources term, it has broader dimensions including institution sustainability, market sustainability, legal policy environment sustainability and impact sustainability. Institutional sustainability looks at those dimensions of the organization which deals with the internal organizational environment such as organizational, managerial and financial aspects. However,

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of which financial sustainability of MFIs has always become the critical point of focus in their sustainability analysis. It is a necessary condition for institutional sustainability.

Some people doubt on whether the necessary of sustainability of microfinance institution in long term when donor's funds stop. They argue that sustainability of the micro enterprises is more important than the long- term existence of the financial institution that stood behind the start-up.... It implies that the long- term sustainability of MFIs is not important as long as money was given to micro entrepreneurs and a start-up help was given. However, literature proves this fact to be wrong. First, possibilities of promoting sustainable microenterprises have been explored through microfinance institutions. Microenterprises after starting up usually need small capital to keep maintaining their operations and still it is difficult for the poor to manage that small capital need. The poor need to have access to financial services on long term basis rather than just a onetime financial support. Short term loan can challenge the visibility of microenterprises and worsen the welfare of the poor (Meyer 2002). Second, microfinance institutions themselves could be financially self-sustainable; they hold out a promise that development can be made to pay for them and even generated a surplus to fund an ever-expanding number of beneficiaries on permanent basis. This promise has captured imagination and mobilized resources and attentions of policymakers, donors, development practitioners and increasingly formal sector financial service institutions. Before, most MFIs have long only relied on donor's fund to finance their growth and donor's subsidies have some certain impacts on some sore business decisions of microfinance institutions. However, by the time the desire to achieve massive scale, obtaining long term sustainability together with the fear of relying too much on donors can undercut both scale and efficiency has spurred institutions to innovate, cut cost, and improve products and services, reinforcing calls for professional, transparency and good governance. None of this is likely in setting dominated by subsidy. All these

progressive efforts help microfinance institutions gradually escape from subsidization to become independent financial institutions that can "pay for itself and must to do so if it is reach very large numbers of people" (CGAP-good practice in microfinance).

2.6.2   Financial sustainability of MFIs

Financial sustainability has been considered as the backbone of every microfinance sustainability activity. According to Dunford (2003), financial sustainability means being able to continuously operate or function towards microfinance objectives without depending on donor support. This definition implies the ability of MFIs to depend on self-operation as well as their possibility of making profit out of microfinance operations. Therefore, a MFI with poor financial performance or a MFI whose profitability is determined after covering some of the operating costs by subsidized resources or funds will not be classified as financial sustainable. Financial sustainability can be measured in several indicators such as operational sustainability (OSS), financial self-sufficiency (FSS) or profitability indicators. Although it is also argued in literatures that sustainability doesn't imply profitability (Morduch 2005) due to the fact that a lot of success microfinance institutions in the world is non-profit NGO institutions, microfinance sustainability is a step toward profitability. There are many levels in sustainability of MFIs. Non-profit NGOs institutions have considered poverty reduction as their main goals so they just need to obtain operation sustainability (OSS) where they could cover their operating cost to maintain their operations regardless the sources of revenues. Financial self-sufficient institutions could cover their costs by operating revenue without using any subsidized base. However, microfinance institutions if achieve profitability, can not only cover their operating costs but also cost of funds, cost of inflation and other non-cash cost without subsidized funds. They even can use their profit to generate excess funds

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for reinvestment and expansion (Christen 1997, Morduch 1999, Makame & Murinde 2007, Rosenberg 2009). According to CGAP 2004, MFIs can achieve both microfinance sustainability and profitability if they are able to reduce their transaction costs, offering better products and services that meet clients need, generate enough revenues and be able to find new financing ways to the unbanked poor households. Financial sustainability of MFIs should be evaluated in a multi-dimensional context where there are several components of performance can be used to measure. However, each of which can be translated into many observable variables depending on research targets so determinants of MFIs sustainable is still a debated subject. Indicators of OSS, FSS, ROA, ROE profit margin… are usually used to measure financial sustainability because an MFI must cover the cost of funds, operating costs, loan write-offs and inflation with the income it receives from fees and interest (Havers 1996, Anduanbessa, T.2009). But, they could be calculated and applied differently up to study purposes. Other factors that are noted in literatures of their influence on financial sustainability of MIFs are also various and not the same due to the use of different proxy variables by researchers. For example, in order to identify indicators of outreach, the loan size and the number of borrowers are usually taken as proxies for the depth of outreach. Finance innovation can be seen through kinds of microfinance productions services, new technology process, types of financial institutions taking part in providing small-scale financial service….

Literatures show that there are tradeoff between financial sustainability of microfinance and outreach. Some argue that financial sustainable is not possible by reaching the poorest people on planet and there is a tradeoff between outreach and financial sustainable. The others think that outreach and sustainability is complementary in nature. As microfinance institutions seek to reach as many poor people as possible in the long run to fulfill their goals of poverty

elimination, it must keep a balanced budget, all while growing to meet the needs of expanding clients. It is clear that this outreach is only possible on a sustainable and efficient basis and sustainability is considered a mean to achieve outreach. For an ideal MFI, institutional sustainability refers to the ability to continue operating as developed financial institutions to successfully provide financial services to the poor (Khandler and Khalily 1995). It also refers to the ability to be financially sustainable in order to become independent from donor subsidies. (Hartarska and Nadolnyak, 2007). Therefore, for the development of the microfinance institutions: *Institutional sustainability was the key to successful provision of financial services to the poor and financial self-sufficiency was a necessary condition for institutional sustainability* (Gonzaler-Vega 1994, Hollis and Sweetman 1998). Sustainable financial MFIs can become permanent part of the financial system.

For all above reasons, understanding the factors affecting sustainability and how MFIs become profitable financial sustainability is very important because it helps evaluate the future of MFIs and helps figure out what should be done to make these MFIs sustainable and hence ensure sustainable provision of microfinance services and sustainable poverty reduction through outreach.

2.6.3   Financial innovation in Microfinance Institutions for sustainable development.

Generally, innovation refers to the introduction or use new ideas, or ways of doing things. Innovation has been widely recognized as a significant phenomenon in any economic sector of either developed or developing countries. According to Davila et al (2006), innovation is a necessary ingredient and an integral part of a business enterprises. Miller (1986) and Merton (1992) also highlighted the importance of new products and services in the financial arena. Microfinance indeed is a subset of financial innovation targeting the small-scale clients with

micro financial products and services that they can afford. Financial innovation in microfinance can be defined as the emergence of new financial products, new organization forms, new processes and systems that financial institutions employ to do business or constantly improvement of the existing product and activities of financial institutions to expand the range of financial products and services, better process, efficient system to meet the emerging needs of the stakeholders. Financial innovation can be successful if it helps reduce costs or increase revenue through introduction of new services, products to open new opportunities of financing and investing as well increasing market clients, diversification choices in the terms of portfolio size and sources of financing. Financial innovation can be measured in three dimensions: product innovation, process innovation and institutional innovation. To fulfil the dual mission for development, the MFI's capacity for innovation is very crucial. It enables MFIs to tackle the challenge of poor linkage between MFIs with their clients for improving efficiency-flow, lending to better returns and clients' satisfaction (Miller 1986). Often microfinance innovation is inclined towards improving the financial affordability, accessibility of financial services and reduces information asymmetry.

2.6.4 Conceptual Model of factors affect to MFIs' financial performance

There are a lot of factors affecting the financial sustainability of microfinance institutions but they can be grouped into internal and external factors. This study will use both internal and external determinants include capital asset ratio, porfolio quality, gearing ratio, size of microfinance institutions, level of GDP, inflation rate to test and examine their relationships between them with microfinance institutions's profitability. ROA is chosen to be proxy variable of profitability and defined as dependent and the others mentioned factors are independant variables.

Figure 2 : Conceptual framework on potential determinants to MFI's profitability.

Internal Factors	Financial Performance (Profitability -ROA)	External Factors
Capital asset ratio		GDP level
Loan quality		Inflation
Gear ratio		
MFI's Size		
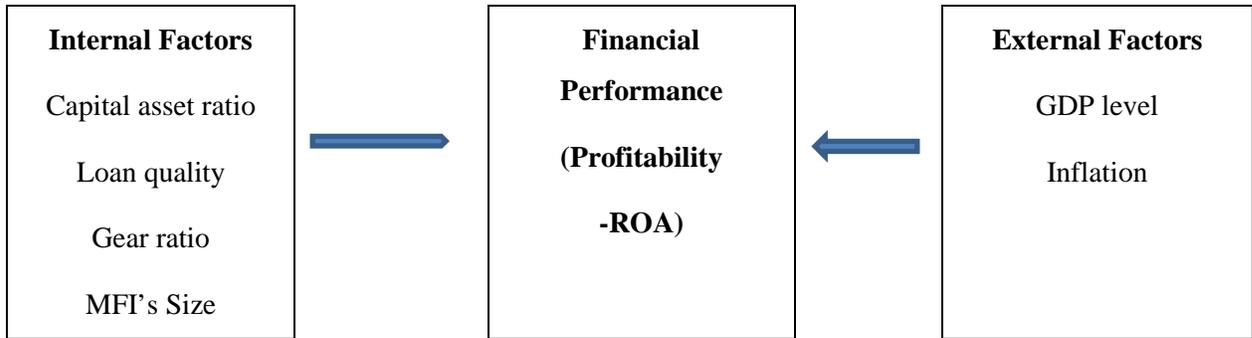
Source: Modifier from the model of Miriu 2011, Abebaw Yenesew

2.7   CHAPTER CONCLUSION

This chapter has reviewed and systemized the existing theoretical issues and empirical literature on microfinance. In summary, microfinance is the provision of small scale financial and non-financial services to unbanked poor people. MFIs are organizations that access to financial resources from banks, government, international donors or other financial institutions to conduct microfinance activities, providing financial services to the poor. Being considered as tools for poverty reduction and social development, MFIs need to attain sustainability to reach their dual targets. The chapter also provided us the interesting link between financial innovation and MFI's sustainability under the effect of environment within which MFIs operate. There are many dimension of sustainability, among which financial sustainability has been captured the attentions of researchers throughout the world most due to its importance in the livelihood of MFIs. Factors affected to financial sustainability of MFI could be divided into two groups: internal and external group basing on management characters of MFIs. Examining these factors to see how they could dominate the profitability of MFI as well as assessing MFI's innovation capacity and their operating environment in comparison with microfinance in other benchmark countries will help us have comprehensive view on the development of Vietnam microfinance.

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CHAPTER 3:

OVERVIEW ON FINANCIAL SYSTEM AND

MICROFINANCE ACTIVITIES IN VIETNAM

3.0   INTRODUCTION

Chapter 3 provided an overview of the social economic and legal environment of Vietnam, the national financial structure, main microfinance suppliers as well as their characteristics. The chapter presented a picture of Vietnam microfinance operation, evaluated the achievements and challenges to Vietnam's MFIs during the sustainable development progress.

3.1   THE COUNTRY OVERVIEW

Vietnam is located on the eastern margin of the Indochinese Peninsula and covers some 331,688 km^2 of which three-fourths is mountainous and hilly regions, a coastline of 3,260 km. The two largest cities are HoChiMinh City and Hanoi. There are 59 provinces and five municipalities with a total of 671 districts subdivided into 10,876 communes. Vietnam's population is over 91 million people.[8] According to the Living Standard Survey published on the1st January 2013, the total working-age population of Vietnam aged under 15 years older was 68.82 million, of which 52.79 million people were in the labor force[9]. The population density varies considerably in Vietnam. Most Vietnamese live in rural areas (around 72% of the population). The main ethnic group of Kinh (Viet) makes up 86% of the total population while 14% are from the 53 small, heterogeneous ethnic groups, of whom the largest are the

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[8] Source: CIA World Factbook.
[9] Vietnam Statistical book 2013.

Tay and Muong. These ethnic minorities, however, remain vastly over-represented on the poverty map of the country.

Vietnam is successful in drastically reducing poverty rates. From 1993 to 2008, 42% of the population, or 35 million people, were lifted out of poverty, reducing the percentage of people living under the national poverty line from 58% to 14,5% by 2008, and by these standards was estimated to have been reduced to 12,6% by 2011. Vietnam is poised to meet its Millennium Goals by 2015. Similarly progress in the face of steadily rising incomes is evident when assessed by international standards of 1.25USD and 2.00USD person/day. Progress has also been substantial in other dimensions of well-being, ranging from high primary and secondary enrolments to improvements in health status and reduced morbidity and mortality. However, the prevailing poverty of ethnic minority in the country is of particular concern. Although Vietnam's 53 ethnic minority groups make up 14% of the population, they accounted for 45% of the poor 2011. Most minorities continue to reside in more isolated and less productive upland regions of Vietnam.

Table 5: Vietnam data on population 2005-2012

	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Total population (million)	83,5	84,4	85,2	86,1	86,9	89,5	90,5	91,5
Population growth	1.04	1.02	1	0.99	0.98	1.1	1.08	1.05
Economically Active Population (%)	48.76	48.69	48.62	48.57	48.52	48.49		
Adult literacy rate (%)	90.3				94			
Life expectancy (years)	70.61	70.85	71.07	71.33	71.58	71.94	72.18	72.41
% of population below the national poverty line		16	14.8	14.5		14.5	14.2	

Population density	253.48	256.11	258.72	261.31	262.58	270.44	273.37	276.32
% of population in rural areas	72.72	72.10	71.47	70.85	70.23	69.61	68.96	
Human Development Index	0.573	0.58	0.59	0.6	0.6	0.611	0.614	0.617
Human Development Ranking (out of 187)						127	128	

Source: Index Mundi, UNDP reports

Nationally, more than half the workforce is employed in agriculture, forestry and fisheries (54% as of 2009). Most of these households have access to land. In addition to farming, at least 35% operate non-farm household businesses. The improvement of physical infrastructure has contributed to the reduction of poverty. Similarly, access to irrigation, high value crops (such as coffee, spices, shellfish or fish in addition to rice) and to a local market positively impacts income generation from both farm and non-farm activities.

In 1990s, Vietnam was among one of the poorest countries with the GDP per capital of 98USD. But thanks to successful results of economic reforms, the GDP per capital income has risen over the past few years from 410USD in 2004 to 835 USD in 2007. The country surpassed GDP per capital of USD1000 in the late 2000s, and now is defined as the lower middle- income country by World Bank. However, there is a large difference between the average per capital incomes of 793USD/year for urban residents and the rural average per capital income of 374USD/year Poverty is more strongly related to ethnicity than to geography and remoteness. In 2008, only 10% of Kinh and Chinese were poor while 52% of ethnic minorities lived below the poverty line. Poverty is vastly more persistent in the northern mountains, Central Highlands, and along the flood-prone delta coastlines where ethnic minority residents live.

With the rapid pace of urbanization, the urban poor in Vietnam also raise a problem. A growing number of workers from rural areas are migrating to the cities to work in private industry and service and many of these jobs are informal and lack employment benefits such as: lower wages, lack access of health insurance, and their children cannot access education without resident certificates. The main reasons for Vietnam's huge success in poverty reduction are government policies to distribute agricultural land to rural households and support for the integration of agriculture into the market economy while job creation in the private sector has been promoted as part of the overall economic reform since 1986.

The labor force of Vietnam is estimated at 51,87 million people and the agriculture sector continues to employ the highest percentage of workers. (The rate has slowly declined from 64% of the labor force in 2000 to 54% in 2007) As the engine of economic growth, the private sector is generating increasing employment in the growing manufacturing and service sector is generating increasing employment in the growing manufacturing and service sectors, including trade, finance and a booming tourist sector. With decreasing rates of infant mortality and increasing life spans, key demographic challenges for the country will be the continuing creation of jobs for the 1,6 million young people entering the work force every year, increasing the supply of skilled labor and the generation of resources to care for an aging population.

With massive economic growth in recent years, Vietnam has an overall low unemployment rate. Vietnam unemployment rate averaged 2.52% from 1998 until 2012, reaching an all-time high of 4.5% in December 1998 and a record low of 1.81% in December 2012.[10] In real numbers, 1.84 million Vietnamese were unemployed in 2012.

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[10] Unemployment rate in Vietnam measures the number of people actively looking for a job as a percentage of the labor force. The figures announced by General Statistics Office of Vietnam.

3.2   VIETNAM'S MACROECONOMIC CONDITIONS

Vietnam has during the last two decades developed into a dynamic and fast- growing market and the country's economy enters its consecutive third years of relative stability proving that its macroeconomic conditions continue to improve. Vietnam's focusing on maintaining a moderate inflation, a stable exchange rate, increase reserves and reduce country risks in order to get out of its recurrent macroeconomic instability that started in the country in 2007. Inflation has declined significantly from a peak of 23% in August 2011 to 6.7% in June 2013. The official exchange rate has been relative stable with a welcome move of Vietnam's authority recently to widen the exchange rate band by 1% rather than defending currency when the Vietnam dong came under pressure. The stock of reserves with the Central Bank has more than doubled in the past two years with reserves covering up to 2.8 months of import at the end of the first quarter of 2013. Although Vietnam's macroeconomic condition remains stable, growth is weakening due to the absence of broad structural reform. Economy's growth has slumped at 5.2% in 2012, the lowest level since 1998. However, it continued to extend its slow growth into the first half of 2013, registering a growth rate of 4.9% in the first quarter and 5% in the second quarter. This slow growth rate was expected to remain in next 2 years because it would take several years to address structural problems facing the country.

Officially jointed in World Trade Organization (WTO) in 2007 and achieved middle income status in 2010 (USD1,298), Vietnam now is an active member of the Asia, Pacific Economic Cooperation (APEC), the Association of Southeast Asian Nation (ASEAN), the Asia-Europe Meeting (ASEM) and regional Free Trade Agreement (FTAs). Integration with the world economy helps Vietnam improve its business climate and enjoy a surplus in its trade balance in near terms. Thanks to the well performance of export sector, especially foreign-invested enterprises, Vietnam has for the first time posted a trade surplus since 1992 and obtained the

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capital current account surplus of 5,9; 5,6 of GDP in 2012 and in 2013 respectively. Strong foreign direct investment FDI inflow together with the surplus in balance of payment helps supporting international reserves of the country.

Vietnam's economy performance has relied on strong performance from agriculture, industry, construction, service and trade where the growth has been decelerating in all sectors. Growth in agriculture, fishery and forestry sector slowed down to 2,7% in 2012 from 4% in 2011 due to a number of natural catastrophes including drought in the North, floods in the North Central region and Mekong River Delta, diseases in livestock and falling prices of most agricultural products after the 2007 global crisis. While service sectors grew up lightly (with service growing by 6.42% last year against a GDP growth rate of 5.03% and productivity relatively higher than in other sectors), domestic sector is still weakening because of several factors including low productivity, structure of resource allocation, impaired bank balance sheets and inefficiency of several state-owned enterprises.

In 2011, the Government decided to shift policy from aiming at achieving high economic growth rate to stabilizing the economy through tighter monetary and fiscal control. Then, a broad three pillar economic program was set up in early 2012 proposing the restructuring of public investment, stated-owned enterprises and the banking sector. According to that, the State Bank provided liquidity and facilitated the merger of several small, weak banks over the past two years together, at the same time implemented a measure to stop all deposit taking and lending activities in gold in commercial banks to reduce bank balance sheet risks. The State Central Bank has also strongly required commercial banks to lower lending rates and put additional stress on banking sector productivities[11]. By all these enforce, the interbank market's function has largely been restored; bank liquidity has eased with high growth in

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[11] World Bank's report.

deposit and lower funding costs. The State- owned Enterprises dominate key industry. Recent estimates show that SOEs account for one-third of all business assets, and one-sixth of employment. They account for one-half of corporate income tax revenue and one-third of domestic value added taxes.[12]The Government has also outlined restructuring plan for State owned enterprises (SOE) in which the Government will retain full ownership of roughly 50% of SOEs that mostly operate in public service areas or are of strategic interest, around 43% of SOEs will be equalized and the rest will be restructured, sold or liquated.[13]

Chart 2 : Contribution to GDP
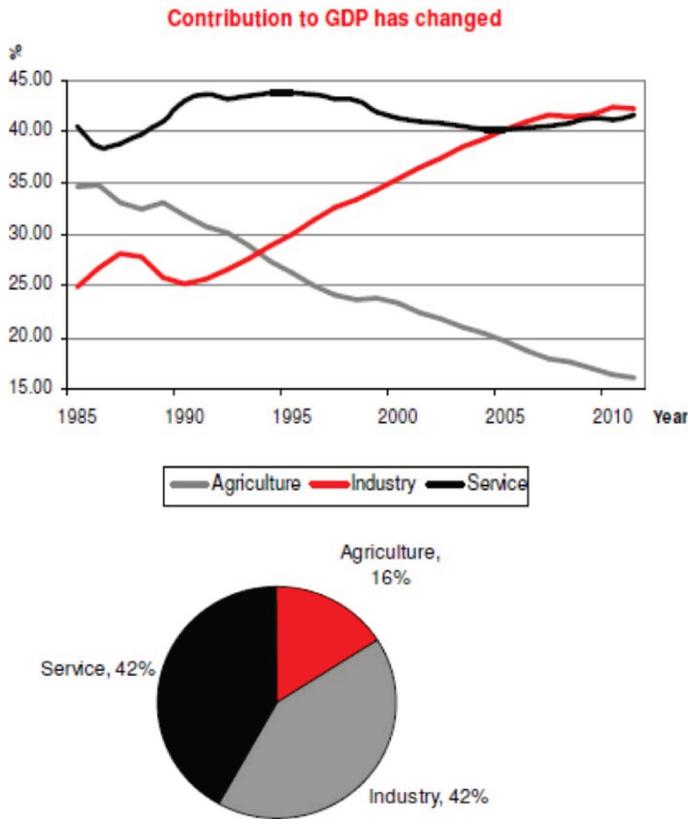
Sources: HSBC

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[12] IMF's data and information.
[13] IMF's report on Vietnam's economy.

Chart 3 : Vietnam's trade volume (USD billion)
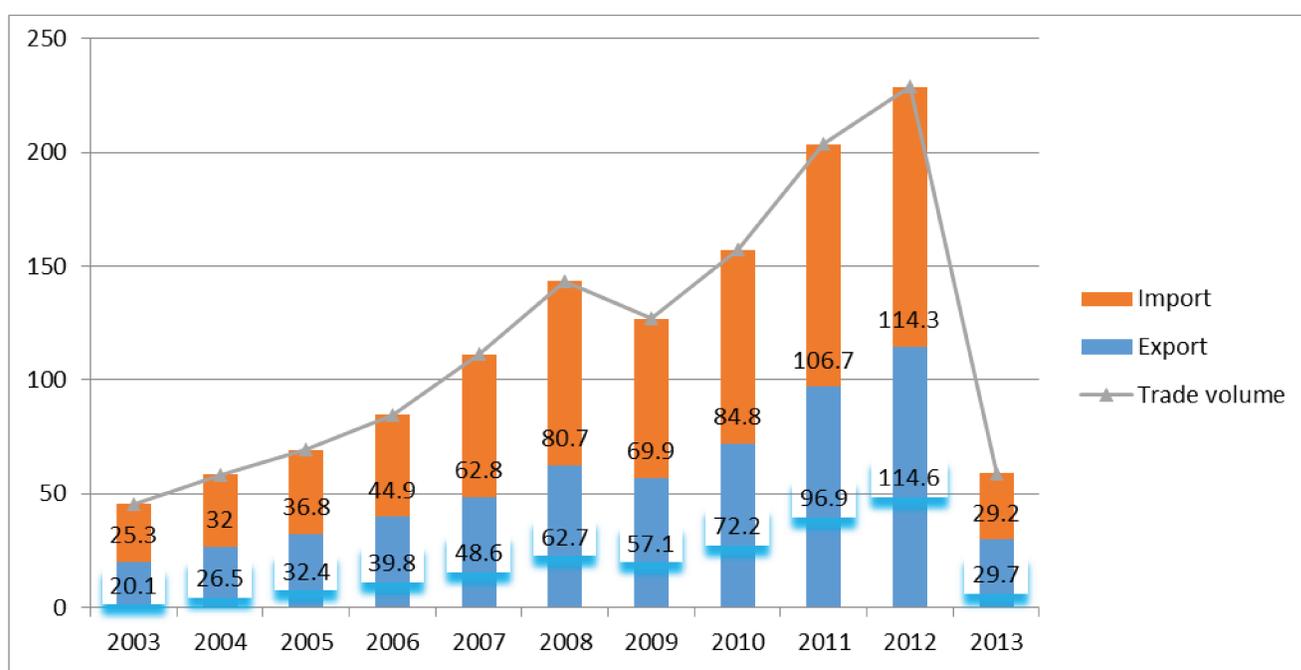
Table 6: Vietnam's key economic indicators:

	2009	**2010**	**2011**	**2012**	**2013**	**2014** (forecast)
Real GDP (percent change)	5.4	6.4	6.2	5.2	5.3	5.4
GDP (in trillion VND)	1,809	2,158	2,780	3,245	3,684	4,155
GDP (in billion USD)	101.6	112.8	134.6	152.8	170.0	187.0
Per capital GDP (in USD)	1,182	1,298	1,532	1,814	1,997	2,174
Gross national Saving (% of GDP)	30.7	31.6	29.7	33.0	29.4	26.3
Gross national Investment (% of GDP)	37.2	35.7	29.8	27.2	24.4	23.1
Customer price index (period average)	6.7	9.2	18.7	9.1	8.8	7.4
Customer price index (% change, year end)	6.5	11.7	18.1	6.8	8.2	7.9
Core inflation (end of period)	6.6	9.8	14.3	9.6	6.5	
Public sector debt (% GDP, end of period)	46.9	51.7	47.9	51.3	50.4	50.5

Current Account Balance (% GDP, end of period)	6.0	-3.8	0.2	5.9	5.6	3.3
Gross international reserves (in billion USD)	14.1	12.4	13.5	25.4	38.7	46.1
Real effective exchange rate (dong/USD, end of period)	116.2	117.4	122.7	122.0		

Sources: IMF report released on August 9/2013,

3.3 OVERVIEWIEW OF VIETNAM'S FINANCIAL SECTOR

Financial system is important in a modern economy. It helps contributing to the economic growth by its core-functions of mobilizing and facilitating the allocation of financial resources. It channels household saving to corporate sector channel and distributes investment funds among firms; it allows inter temporal smoothing of consumption by households and expenditures by firms; and enable households and firms to share risks[14]. The Government also intervenes in financial system to influence macroeconomic variables such as interest rate, inflation …These functions are common to the financial systems of all economies past and present, East and West. However, the form of these financial systems varies considerably among economies due to the differences in size, complexity, available technology as well as the differences in political, cultural and historical backgrounds. In Vietnam, after renovation known as ''DOI MOI'' in 1986, the country's economy shifted from a centrally planned to a market-oriented economy. The financial sector takes center stage in the renewed efforts to reform the Vietnamese economy. Before Doi moi, during the era of central coordination and planning, the Vietnamese financial sector was completely subordinate and instrument to the achievement of Government objectives in the productive, state-owned sector. There was a "mono-bank" system (the World Bank 1994) with the operation of the only three financial

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[14] According to Franklin Allen and Douglas Gale in *Comparing Financial* Systems

organizations: The National Bank of Vietnam (NBV-predecessor of State Bank of Vietnam nowadays); Bank for Investment and Development of Vietnam (BIDV) and Bank for Foreign Trade of Vietnam (VCB) in which the NBV had a monopolistic position. The NBV was the only financial institution allowed to supply short-term loans to industrial sectors while BIDV had authority over infrastructure funding and the capital investment funding to state owned enterprises (SOEs).

The beginning wave of economic reform in the period 1986-1996 resulted in transforming the mono-bank system into a two-tier banking system through the separation of the large State-owned Commercial Banks (SCBs)[15] from the National Bank of Vietnam and the creation of new State Bank of Vietnam (SBV) upon the new legislation provided by Ordinance on the State Bank of Vietnam, passed on May 23, 1990. The Government initiated the new SBV acting as the central bank and assigned its commercial banking activities to the four sector-specialized state owned commercial banks. In 1990s, there was also the entry of joint stock bank (JSBs) and foreign bank branches which operated limitedly under restrictions. Non-banking financial institutions such as finance and insurance companies (ex. Post Office's saving Co…) have come to exist in the economy as well but mostly executed the function of mobilizing funds in long –terms from general public. July 2001 remarked the appearance of stock market in Vietnam but it is still infancy.

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[15] Four large State-owned Commercial Banks (SCBs) are: Vietcombank, Incombank, VBARD, and BIDV. Nowadays there are another two state-owned commercial banks, the Mekong Delta Housing Development Bank and the Bank for the Poor

Chart 4 : Financial institution system
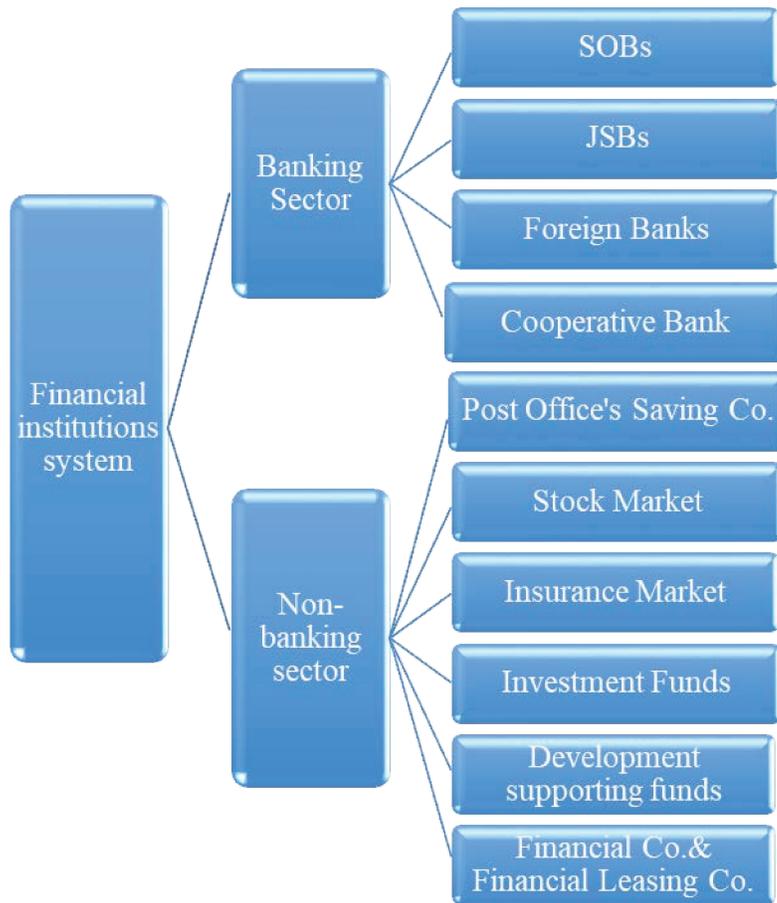
3.3.0 Banking sector

Vietnamese banking sector is concentrated at the top but fragment in the bottom. After "Doi moi", the State bank of Vietnam has still kept its traditional role as a central bank of the formal financial system. With a wide network branches in almost 59 local provinces and 01 regional office in Hochiminh City to look after the south, the State bank of Vietnam (SBV) regulates and supervises banks, non-bank financial institutions, the regulated-financial cooperative, People Credit Fund. Some certain commercial banks are still assigned to provide banking services to special market segments. For example: Vietnam Bank for Agriculture and Rural Development mainly focuses on rural and agriculture sector….

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During the last 20 years since the beginning of the banking reform, this sector has seen a lot of changes in terms of asset expansion, types of bank, quality operations…. There are about 100 players in the banking market today including state-owned commercial bank (SOCBs), joint stock commercial banks (JSCBs), joint venture banks (JVBs), foreign banks and foreign branches (FBs & Fbs). The footprints of foreign banks and foreign branches are increasing while the number of joint stock commercial banks declined due to mergers and equalizations. The total domestic assets of the whole system rise nearly triple from VND 1,1193 trillion USD 53.3 billion) in 2008 to VND3,272 trillion (USD155.8 billion)[16] in 2012, up 2.5% to 2011. However, Vietnamese banking capital sizes are still lower in comparison with regional peers such as those in China, Japan, India, Malaysia, and Thailand.[17] The SBV decided to put pressure on its commercial banks to maintain and increase theirs bank capital adequacy through regulations on minimum chartered capitals and minimums capital adequacy ratio (CAR)[18].

Although very limited in number, the domination in Vietnamese banking still belongs to the 5 SOCBs which hold over 60% of the banking sector's assets and nearly half of all bank deposit and total loan. Having a wide country-network and strong brands, SOCBs possess a large client base. Particularly, thanks to the backup of the Government, SOCBs even monopolized in some areas such as lending to SOEs. However, in the relation with SOEs, their asset quality is deteriorated due to the non-performing loan that belongs to SOEs higher than other enterprises (nearly 60%, according to SBV's statistics by the end of 2010). During the last recent years, the SOCB's market share has significantly shrunk, and has been gradually replaced by JSCBs

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[16] IMF: Vietnam 2012 article IV Consultation 7/2012

[17] Vietnam was not on the top Asian banks based on total assets and market capitalization

[18] Minimum chartered capitals = VND 3,000 billion (equivalent to USD141 million), Minimum CAR=9%.

which are operated actively. By the end of 2010, JSCBs have successfully grabbed from the SOCB around 43,4% and 37,1 of deposit and credit market share respectively by focusing on retail banking and better catering the need of small and mediums enterprises. But, almost JSCBs have registered-capital between VND2000-3000 billion, some of them couldn't meet the requirement of SBV on minimum chartered capital and capital adequacy ratio. Accordingly, they have to face with liquidity problems and some small and weak JSCBs have to be merged.

The competition in Vietnamese banking market seems to be harder and harder with participation of more and more foreign rivals. The year 2011 saw 53 foreign banks and foreign branches in which there are many famous names in list of top world's best banks like: HSBC, Citibank, ANZ, Deutche Bank, Societe Genegal…but their operations are still under their true potential due to the Government's limitation in terms of asset and banking activities. These foreign participants have advantages of high technology and management, sophisticated products and services with high quality and they particularly have many international experiences in retail banking which is still considered as potential field in Vietnam banking market now. Some foreign banks are still holding stakes in domestic JSCBs. In the beginning of 2011, the SBV permitted to lift the limits in fund mobilization for foreign banks, creating more favorable playing field but at the same time more challenges to domestic commercial banks to restructure and upgrade their operations to enhance their competitiveness.

There is another participant in the banking sector: The Cooperative Bank. This bank is renamed from the Central People's Credit Fund which was established in 1995. People's Credit Fund was a community-based financial cooperative with local People's Credit Funds

operated in almost 54 provinces and cities. Now it is the bank under the supervision of SBV and operates under the Banking Law and Credit Institution Law and is allowed to attract and mobilize from shareholders including local PCF and the four SOCBs, donors and public deposits.

Chart 5 : Number of banks
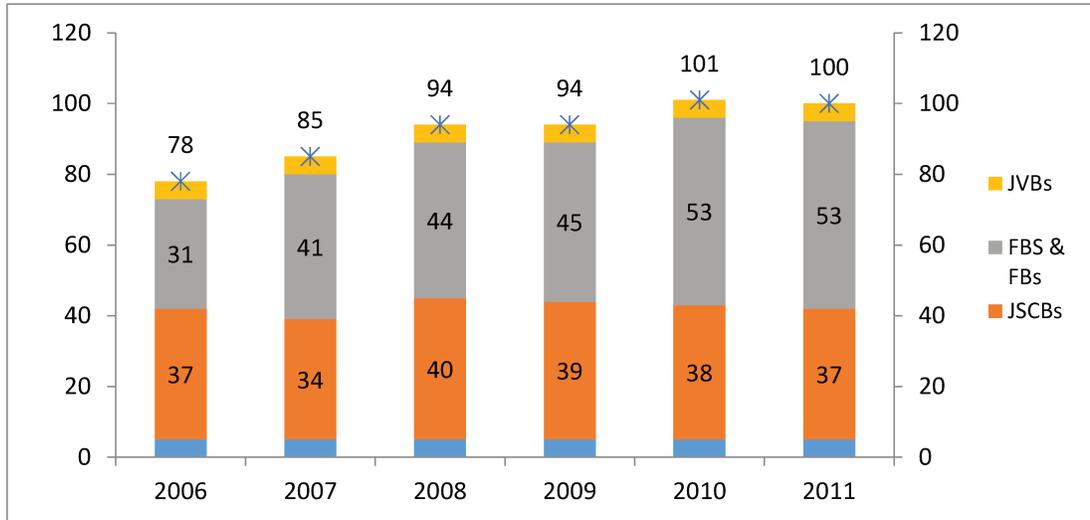
Source: State Bank of Vietnam
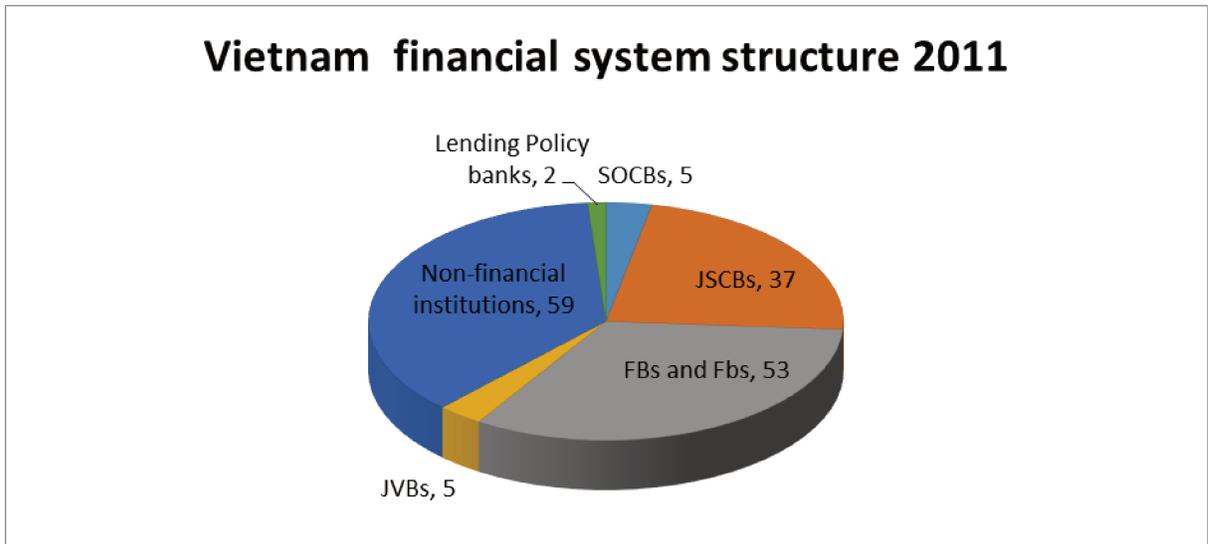
Source: State Bank of Vietnam

Table 7 : deposit/credit market share between banks

	JVBs & FBs		JSCBs		SOCBs	
	Deposit market share	Credit market share	Deposit market share	Credit market share	Deposit market share	Credit market share
2005	7.9	9.5	17.8	16.4	74.2	74.2
2006	8.1	9.3	23.0	23.7	68.9	67.0
2007	8.8	9.0	33.1	33.9	58.1	57.1
2008	8.1	10.5	35.9	33.8	56.1	55.7
2009	7.5	9.1	42.8	36.7	49.7	54.1
2010	8.9	13.6	43.4	37.1	47.7	49.3

Source: VCB- banking sector report September 2011.

Chart 6 : Change in asset, equity, chartered capital
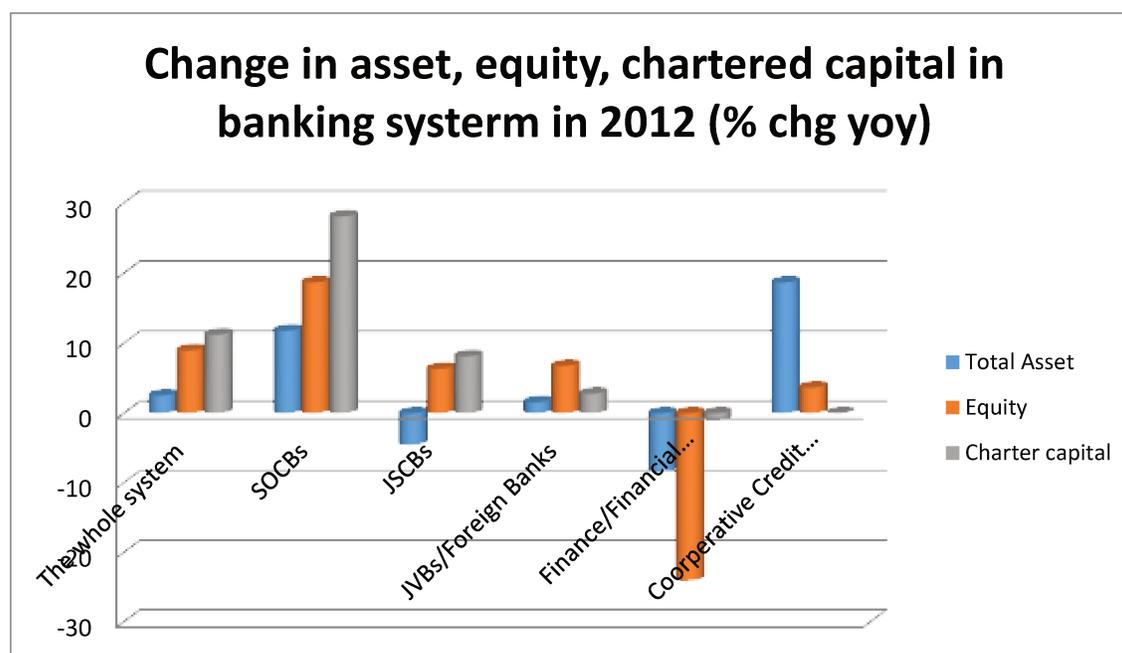
Source: State Bank of Vietnam

Vietnam bank sector had experience a period from 2002 to 2010 of very fast-growing pace with the average growing rate of 34% and 28.91% in credit and deposit respectively. That was thanks to the development of private sector, the booming of real estate sector in 2007, 2008 as well as the expansion wave of banking network and flexible monetary policy from the Government in order to pump credit to support export-lead GDP growth. However, in comparison with regional peers in terms of profitability, Vietnam is still lower with the returns on asset at 10.9% while others are above 13%. Since 2011 until now, the financial situation of Vietnamese banks has deteriorated due to high rate of non-performing loan (NPL). This rate of the whole sector increased sharply from 3.44% to 4.5% by March 2013 among commercial banks. But international banking researchers warned that in reality, this figure must be much higher than the announced one, raising concerns about the quality of financial figures as well as quality of credit. In order to cope with the situation, SBV forced its commercial bank to make effort to improve debt classification and provision. In addition, Vietnam Asset Management Company was set up under the Decree 53 issued on May 18, 2013 by Prime Minister to buy bad debts from banks at book value through special zero interest, five-years maturity-bonds or at market price without bond. This company operates non-profit and is part of SBV, which is considered to be a visible step of the Government.

The growth of credit and deposit in last 2 years saw a decline to 12% and 11% in 2011 respectively, the lowest rate ever recorded. Credit to the economy at low level can be attributed to several factors like: the caution of commercial to extend credit due to high NPL rate, instead, they tried to collect debts; the collapse of real estate balloon prevented credit capital flew into this risk sector, the Government's tight credit policy. In addition, during 2002-2010 in Vietnamese banking market, there has been always an existence of liquidity risk because

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credit growth is much higher than deposit and GDP growth. (This average growth rate in percentage is 32:29:7). Economic researchers said that credit growth ranging from 14% to 20% can generate a GDP growth of 7% without causing a credit bubble but when this figure exceed 20% the health of the economy will be threatened[19]. Therefore, in the Vietnam's current economic situation, it is better to "grow slow than grow with vulnerability".[20] Now with continued growth in deposit, limit growth in credit together with the strong support from SBV in macroeconomic stabilization, the system liquidity has been gradually restored.

Chart 7 : Banking credit, deposit and GDP growth
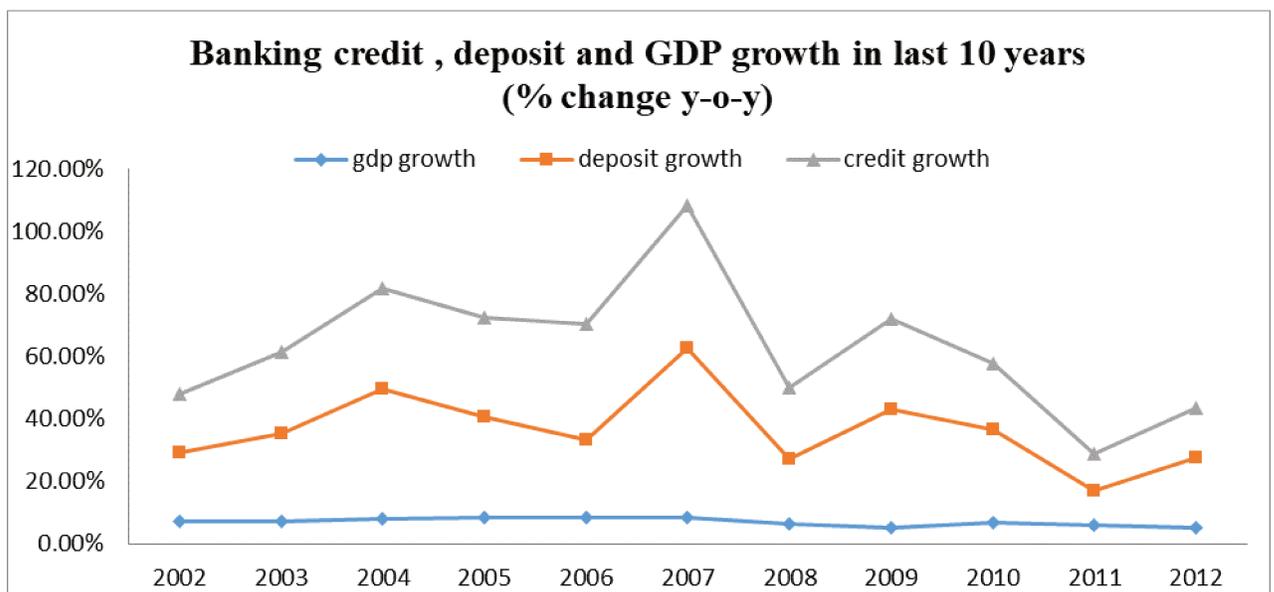
Sources*: State Bank of Vietnam; Vietnam Statistics Office.*

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[19] Report from Vietcom bank
[20] World bank report

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Chart 8 : Deposit/credit distribution

Deposit distribution by banking group in 2011

2 Lending policy banks 5%

Other credit íntstitutions 46.86 47%

SOCBs 48%

Credit distribution by banking group in 2011

2%

56%

42%

■ 2 lending policy banks
■ Other Credit institutions
■ SOCBs
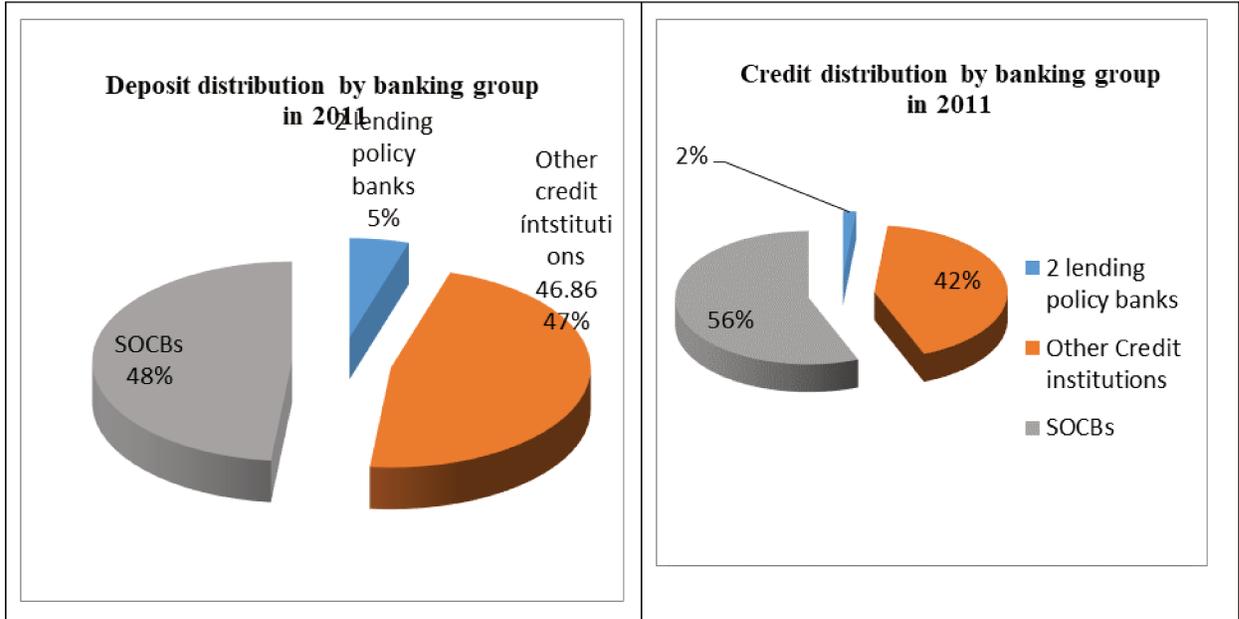
Source: State Bank of Vietnam.

Chart 9 : ROA/ROE of some regional countries

ROA & ROE of some regional countries in 2010

	Vietnam	Indonesia	Malaysia	Philipine	Thailand
ROA	1.02%	3.10%	1.80%	1.60%	1.10%
ROE	10.40%	25.90%	18.90%	13.30%	13.60%
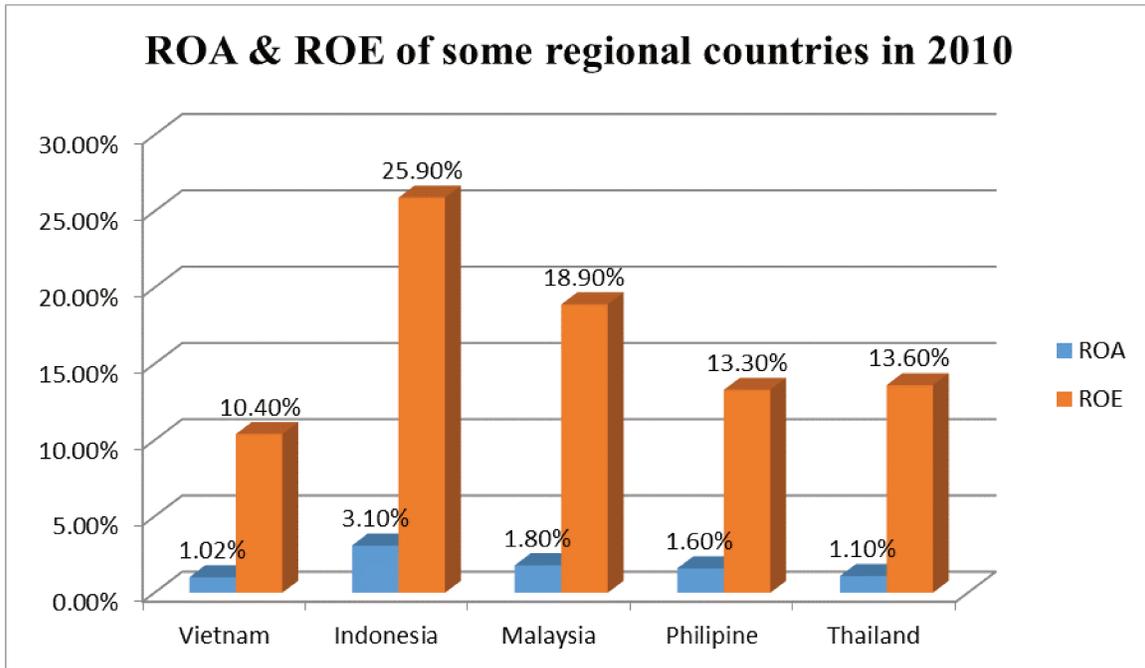
Source: Asia Economic Monitor, December

Table 8 : Non-performing Loans of Financial Credit Institutions in Vietnam

Non-performing Loans to Total Gross Loan of Financial Credit Institutions in Vietnam (%)	
Group of Vietnamese Credit Institutions	**3.44%**
State-owned commercial Banks	3.62%
Joint stock commercial Banks	2.44%
Finance Companies	3.11%
Financial Leasing Companies	51.7%
Group of Foreign Credit Institutions	**2.09%**
100% Foreign Banks	1.21%
Joint venture Banks	4.46%
Foreign branches	1.63%
Finance Companies	5.52%
Financial Leasing Companies	5.88%

Source: Direction and solution for restructure of banking sector 2011-2015

Although still set up the ceiling interest rate to guide commercial lender, in 2002 the SBV have allowed financial institutions to negotiate their interest rate with their clients based on their client assessment. However, since 2008, the bank system has undergone a chaos in interest rate movements due to high inflation and liquidity risk. By 19/08/2011, the SBV had adjusted discount rate 3 times, refinancing rate 4 times and OMO rate 6 times in an effort to bring inflation under control. The period from March to May 2011 also witnessed the interest rate racing among banks due to VND liquidity tension. Although the VND deposit rate was capped at 14%, the actual rate that banks offered to customers was much higher than that. Accordingly, the lending interest rate soared up to above 20% at some points of time. The SBV

forceful in requiring banks to lower the lending rates, for both new and existing loans, bringing the lending rate down to 17% - 19% in September 2011 via the agreement withthe12 largest banks, in which participating banks strictly maintain the VND deposit rate cap of 14%. Currently, it is believed that 60% of loan portfolio is subject to a lending rate of below 15%. Semi- formal microfinance organizations and future microfinance institutions regulated under Decree 18/165 will not be subject to the interest rate regulation.

Policy lending is a key feature of Vietnam's financial sector. The Vietnam Bank for Social Policy (VBSO) is set up to serve the poor and other beneficiaries of Government support. It lends on subsidized and non-market terms. Therefore, its interest rate offered below 10%, created an unfair playing field among competitors in the Microfinance sector.

Chart 10 : Deposit/GDP and Domestic credit/GDP
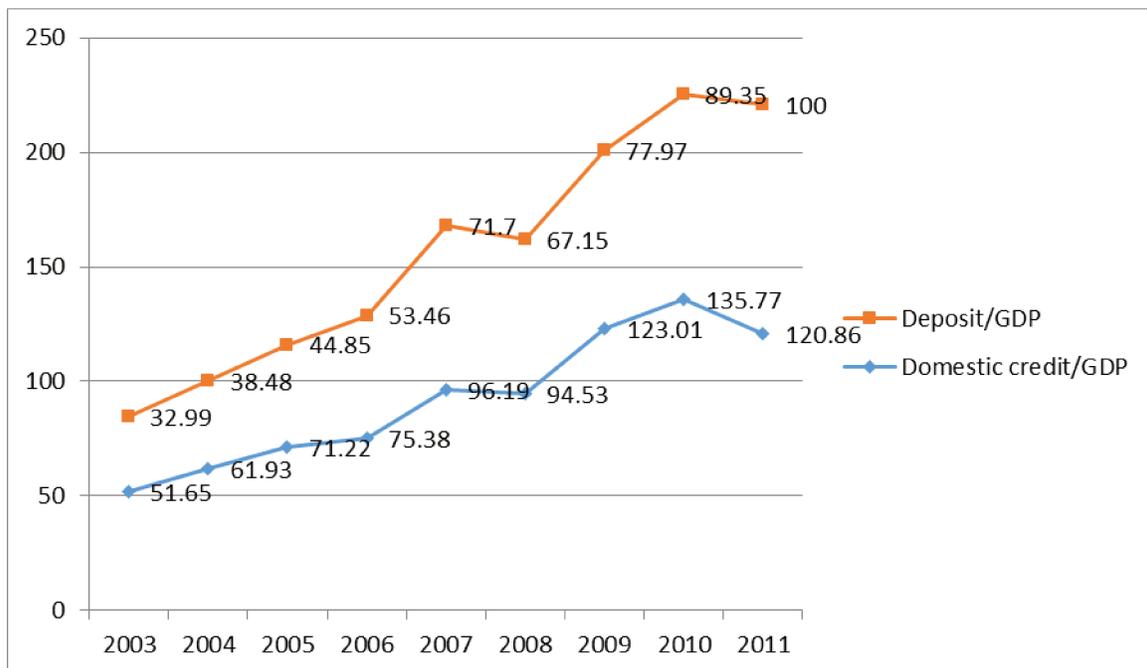
Source: Statistic Office

3.3.1   Non-banking sector

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Financial Leasing Companies: The first financial leasing company was established in 1994 by Vietnam Foreign Trade Bank (Vietcombank), however, financial leasing market was officially launched in Vietnam in 2005 after the Decree 65/2005/NĐ-CP by the Vietnamese Government and until now it is far under its true potential with a limited awareness of customers about financial leasing activities. There are 12 financial leasing companies in Vietnam today including joint stock companies, 100% foreign companies and domestic leasing companies which are owned directly by SOCBs. These companies perform medium and long-term credit activities by leasing industrial and/or construction equipment, transport means, and other types of capital to manufacturers. Although competition between leasing companies is not high, their market share in term of capital mobilization and lending have been reported low too due to the fact that they cannot compete against traditional commercial banks and almost Vietnamese leasing companies have only simple leasing activities. They mainly mobilize capital from bank parents' loans but the regulation of State Bank for that type of loan is too strict and some commercial banks saw their ratio of outstanding loan on mobilized capital over 100%. All leasing companies have to face to the liquidity troubles though they have to try hard to collect bad debts and limit bad debts occurring. There are the followings their operations are providing medium and long-term credits through leasing activities to manufacturers, they usually spend great amount of capital to buy high value assets like new advance equipment, technology chains for leasing without collaterals while having small registered capital[21] and modest mobilized capital. In addition, financial leasing companies cannot supervise their customers to use their asset in the right purposes, sometimes they receive their assets back in

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[21] There is no discrimination between domestic and foreign owned leasing companies in terms of required charter capital: they all have got registered capital of VND100 billion before 2010 and VND150 billion from 2010 onward- Decision 40/2007/QD-NHNN November 2, 2007.

poor conditions or even cannot get them back. According to data reported by the National Financial Supervisory Committee, financial leasing firms had total assets of VND 19,2 trillion but negative equity of VND 2,1 trillion, capital adequacy ratio (CAR) at minus 11% while their bad debt ratio has risen about 59%. They have the highest bad debt ratio among credit institutions. Ten years ago, the establishment of financial leasing companies in Vietnam had been considered to have bright future and opportunities for small and medium enterprises to assess to formal capital but now they are really in hard time situation.

Insurance Companies: last recent years, insurance sector in Vietnam has seen a noticeable growth thanks to the growth of Vietnamese middle-class population with their rising income and awareness on the need of both life and non-life coverage. In addition, the Government has decided to give much more spending on infrastructure and social-well fare projects in order to boost economy growth and stoke demand for insurance coverage both personal and commercial[22].According to the Association of Vietnamese insurers in 2011, direct written premium jumped 21.6% over 2010 level to 37.5 trillion Vietnam Dong (equivalent to USD1.78 billion). Non-life insurance accounted for the majority of overall premium at 57% with the domination belong to domestic insurers. At the end of 2012, the total number of insurance companies in Vietnamese market was 57 in which 29 was non-life insurer, 14 was life-insurance companies, 12 were insurance brokers company and 2 were re-insurance companies. Besides there were 32 representative offices of foreign insurance and insurance brokers companies. In 2013, the market would welcome at least two more new insurance companies: one is 100% Australia investment company and the other would be a joint venture life insurance company of BIDV Insurance company (BIC). The fact shows that Vietnamese market is more opened and invites foreign investors. More and more foreign insurance

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[22] According to Deloitte- Growth opportunities for financial services in Vietnam

companies get access to the highly potential Vietnamese insurance market. Recently there are about 11 foreign-invested non-life insurers out of a total of 29. With respect to life insurance, the market is clearly under the control of 14 out of 15 life foreign insurance companies. Regarding brokerage services, there are 7 domestic and 5 foreign invested companies operating in this area with foreign firms making up more than 80% of the market for brokerage services. Foreign partners taking part in insurance market not only come for Asia such as South Korea, Singapore, Taiwan, China but Europe and America also. Although the insurance penetration in Vietnam is still low: 0.68%, 0.59% for non-life insurance and life insurance respectively over GDP Vietnamese insurance market still have a lot of room for both domestic and foreign investors to grow. It is considered to be one of the fastest growing insurance markets in the world with a double- digit growth for the past few years and is expected to go on with the same growth trend in the coming years also.

Chart 11 : Insurance premium % of GDP
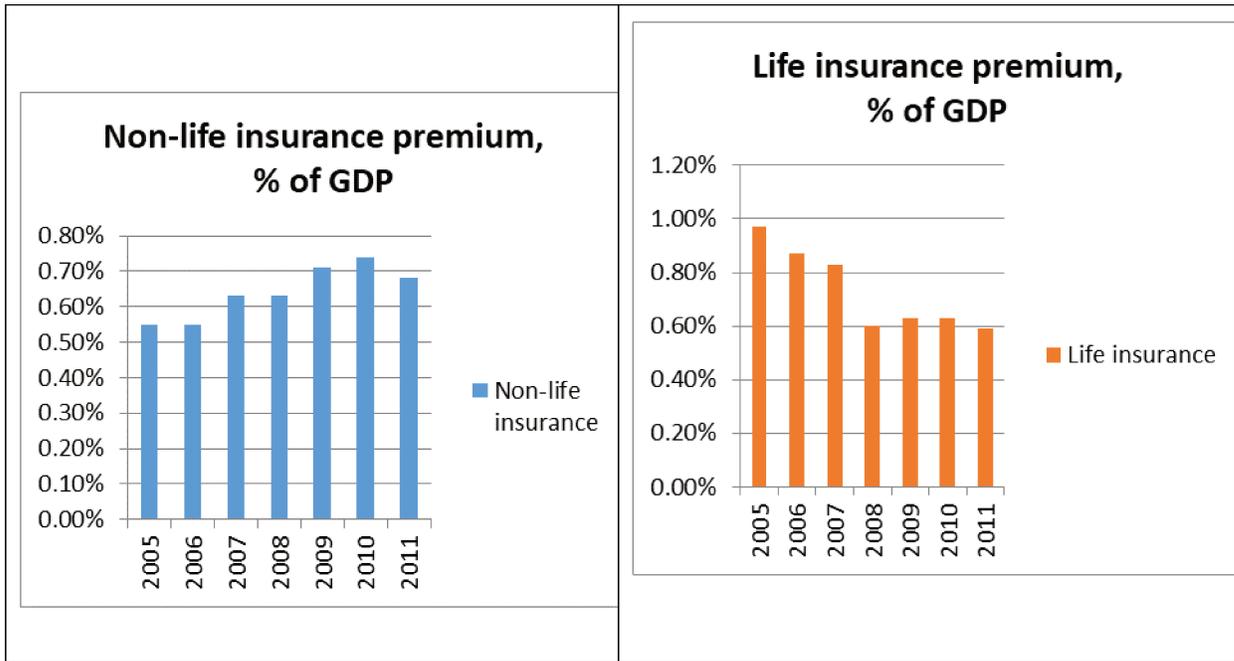
Source: Statistic Office

Stock exchange: Vietnam has been endeavoring to launch a stock exchange since 1992, but until 2000, that intention became real with the establishment of Securities Trading Centre in HoChiMinh city (late HOSC). Five years later, a sister bourse, the Hanoi stock exchange (HNX) was set up and trade mostly small-cap and OTC stocks. Initially, only 2 equity issues were listed: Refrigeration Electrical Engineering Joint Stock Corporation (REE) and Telecommunication Material Joint Stock Company (SACOM), but as 2012, there are 329 companies listed the one of the two stocks- exchange.

Over the past 9 years, the value for market capitalizations of listed companies in Vietnam stock exchange has fluctuated between more than USD32,933,060,000 in 2012 and USD 154, 365,400 in 2003[23]. The products available for trading are Vietnam equities, Government bonds, corporate bonds. Foreign investors can take part in the market through opening account in one of the local brokerage firms. The operations of the two stock markets are under the control and supervision of the State Securities Commission (SSC) under the Securities Law which was enacted by the Vietnam Government in 2007. The year 2007 was also the spectacular year of Vietnamese stock with the VN index soaring to all time high of 1,174 but after that the market downed quickly. In 2008, the market fell 66% from 921 to 316, since then it has rarely crossed 500. In 2011, Vietnam was the third worst performing market in the world, losing 27%. However, recently with the stability of macroeconomic conditions together with effective measures of Vietnamese Government to spur investment such as: letting foreigners buy larger shares of their companies, add covered warrants, derivatives and other products. In 2013, Vietnam's regulators are planning to merge the Hanoi and Hochiminh city exchange. These positive impacts help make Vietnam's economic as well as Vietnam equity

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[23] Date provided by Mundi.

market brighter and more attractive to foreigners. According to Bloomberg, international investor has bought USD244 million of Vietnamese stock so far this year, the most since 2008 and the VN index is now up 48% since the start of 2012.

Chart 12 : Market capitalization
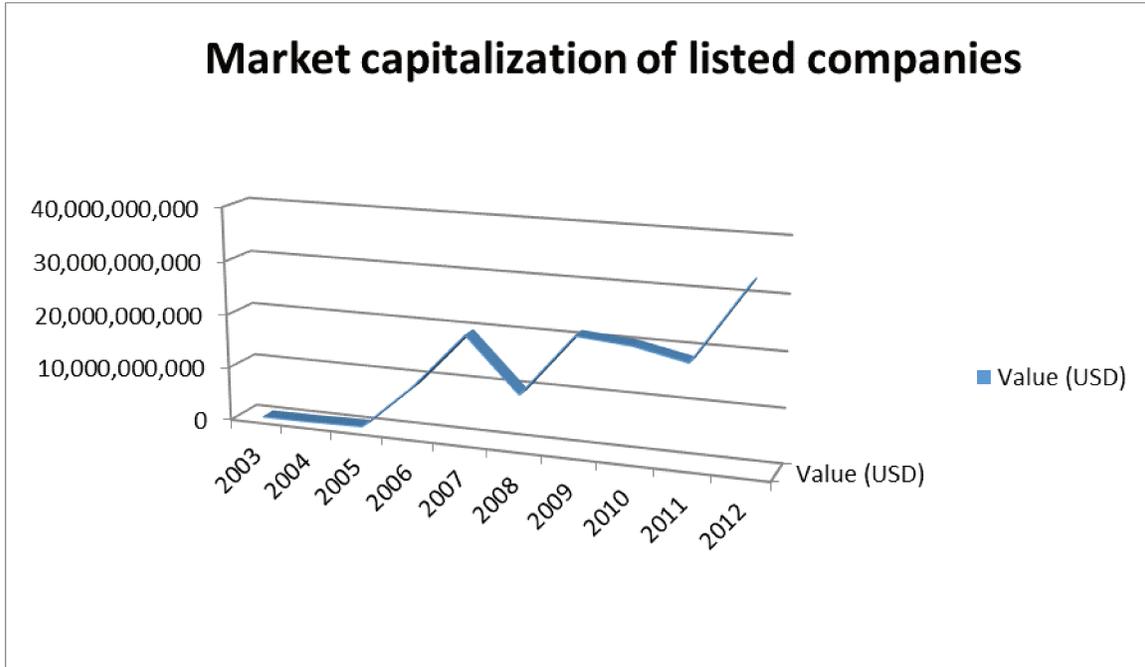
Source: Mundi Index

3.4   ACCESS TO THE FINANCE THROUGH THE BOTTOM OF THE PYRAMID

The emergency of microfinance is the answer for "unmet" question of financial sector. In Vietnam, microfinance plays a very important role in the National Poverty Reduction Program with the target of establishing and developing a system to provide financial services for economically disadvantaged people. Therefore, the traditional market of Vietnam's microfinance is about 13 million poor and low-income people, or 2,1 million poorest and 1,5 million low income households in the bottom of the economic pyramid (BOP) whose are mostly rural. In this market, Vietnam Bank for Agriculture and Rural Development (VBARD),

Vietnam Bank for Social Policy, Co-operative Bank with its 1,037 local People's Credit Funds constitute the market leaders, the backbone of this sector. Besides, there is the participation of semi-formal Microfinance Institutions which are institutions with broad social mandate, and affiliated with either government, mass organizations (MOs) and/or international NGOs. These microfinance institutions are being formalized under the two Government's decrees and circular relating to microfinance institutions in Vietnam.[24] Finally, informal lender groups including family members, friends, ROSCAS[25], and money lenders composed of pawnshops, marketing agents, small traders…also provide microcredit in cash or in kind with short term tenor and mostly without collaterals. Their credit decisions just only based on their trust or knowledge about borrowers thanks to living in the same community with each other.

With a participation of various sources of microfinance providers, characteristic of Vietnam microfinance market is highly fragmented development and overlapping in some places. The domination of Vietnam bank for Social Policy in this sector with its subsidized operations and political targeted lending programs results in sensitivity of interest rate and quality of financial services as well as a specific concern about the sustainability of microfinance institutions. Rural poor accessing the formal, semi-formal and traditional service providers often must satisfy their requirements from a combination of the multiple available sources and product ranges. However most micro-customers would prefer to use one provider for all their financial needs, but few providers are fulfilling this broader demand. Therefore, customer generally appear to compose a suitable package of financial services for themselves from multiple sources and multiple borrowing is wide spread and largely undetected due to lack of coordination in the formal sector to compare client portfolios and the absence of credit

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[24] Decree No. 28 and 165 and Circular No.02. These regulations allowed for licensed and non-licensed microfinance institutions.

[25] Ho/Hui which are local Rotating Savings and Credit Association. (ROSCA)

reference systems (credit bureau), client rating and other early-warning systems. Nowadays, the demand among the LIHs of Viet Nam is for well-designed, affordable and customer-responsive financial products delivered flexibly and conveniently; such as larger and differently structured loans as well as for a broader range of services, including micro-insurance, leasing finance and remittances. So, the 'unmet demand' in Viet Nam's microfinance market does not relate to 'outreach', but rather to the lack of 'one-stop' service outlets offering a broader range of customer-responsive financial products.

Table 9: Percentage of poor households selected by localities borrowing or having debts in the past 12 months by source of loan

Year	Whole country	In total households borrowing or have debt by source of loan						
		VBSP	VBARD	Credit Organization	Political Social Organization	Private money lenders	Relative/Friends	Others
2005	53.9	52.2	19.8	3.6	8.1	9.5	25.9d	3.5
2006	55.0	53.3	19.9	3.5	7.8	9.6	25.8	3.3
2007	55.3	54.3	18.9	3.3	7.9	9.9	25.8	3.5

Source: ADB -2010

It is estimated that roughly 70 or 80% of the poor are able to access some form of financial services, mostly are short-term credit and savings and that formal banking system appears to reach a substantial number[26], reflecting the rapid growth of formal bank and the "crowding out" of informal sectors. However, when having capital demand, rural households still have trend to find loans from informal credit providers although in "this black market", money lenders even can provide loan at a very high interest rate. It means that not all the mentions poor especially the poorest have access to formal financial services or in other way,

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[26] World Bank: "Developing a Comprehensive strategy to expand access to microfinance services"

microfinance services in Vietnam do not effectively reach the poorest. The fact shows that among the poor, there is a "break out" of some who are able to be clients of VBARD- a commercial bank, who are the eligible for targeted-policy credit programs- they are clients of VBSP- and who are totally excluded from the attractive formal market, then finding their borrowings from informal financial providers. Results from market survey reported that only half of households classified as the poor by local authorities and to be served by the formal banks. The Vietnam Bank for Social Policy, although defined itself as the bank for the poorest, takes the responsibility to distribute targeted-policy credit program to these disadvantaged clients locating its limited funds to some non-poor households. IEMA study found VBSP providing credit to non-poor household in all study villages, 31% of VBSP's loan went into higher income group, and only 11% went into the poorest[27]. However, thanks to VBSP, formal financial services has reached ethnic minorities who are considered as poorer than ethnic Vietnamese. Among ethnic minorities, 58% of all loans and 70% of all resources borrowed stem from the formal financial sector in which loans from VBSP account for 33% of all credit[28].

Table 10 : Access to Credit by Ethnicity in Vietnam

	% of households borrowing from different lenders		**% of resources borrowed from different lenders**			
	2006		2004		2006	
Lenders	**Kinh & Chinese**	**Ethnic minority**	**Kinh & Chinese**	**Ethnic minority**	**Kinh & Chinese**	**Ethnic minority**

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[27] IEMA study 2006, World Bank 2009

[28] ADB 2008: Report on Microfinance Industry.

Formal	25	36	61	68	70	69
VBSP	7	18	3	16	5	30
VBARD	17	18	42	51	47	38
Other banks	2	0	17	1	18	0
Informal	21	23	39	31	30	31
Employment Support Fund	1	1	1		0	1
Credit Organizations	2	1	4	2	4	6
Mass Organizations	3	3	1	3	2	4
Money Lenders	4	5	6	5	4	5
Friends & Relatives	12	13	25	19	19	13
Others	1	2	2	3	1	2
Total	41	34	100	100	100	100

Source: ADB: Report on Microfinance Industry in Vietnam 2008

Semi-formal players in microfinance include Non-Government Organization microfinance programs. They have some certain positive characteristics in comparison with formal players and seem to reach the poor even more effectively than the VBSP. They can make use of the advantage of Mass organizations network to providing very small-scale loans of average VND1,603,200 (equivalent to USD102) to women and the poor in the remote and disadvantaged region. It is generally accepted that the smaller the amount, the poorer are clients because better-off are not interested in small loan[29]. Besides, microfinance products of semi-formal microfinance providers are usually in line with other development activities such as health care and agricultural extension in order to achieving the goal of poverty reduction.

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[29] The average loan balance per borrower of VBSP are higher (around VND2,498,500 or USD160)-

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Almost profitability of microfinance institutions comes from their loan interest due to the limitation in number and types of financial products and services in Vietnam microfinance market. The main available are savings, credits, almost non- products or services of micro insurance, remittances, financial leasing…. So far it seemed that most of Vietnam microfinance providers only focus on boosting their credits to clients

Figure 3
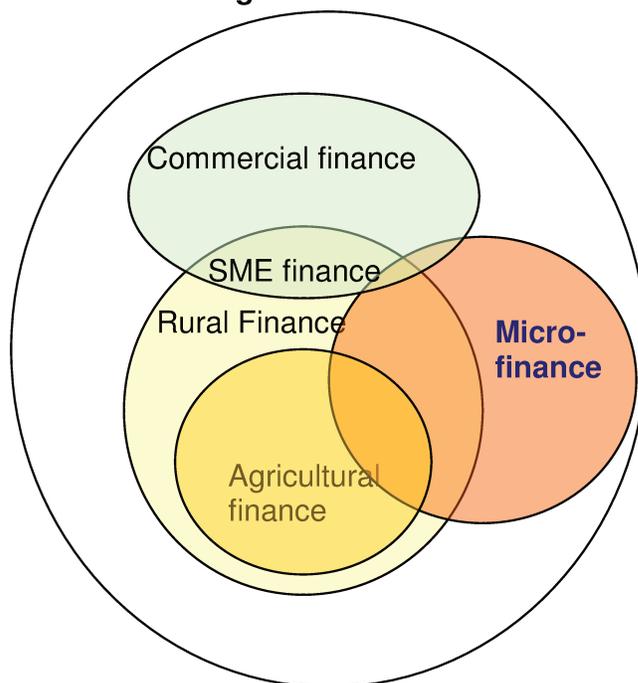
rather than enhancing their small-scale saving products. Reasons are: for formal providers, as a commercial bank, VBARD prefers long-term deposit than small-scale savings in short tenor because of increasing costs, others such as VBSP and Vietnam Post and Saving Company don't have much motivation to expand saving services because they are required to transfer their mobilized savings to other Government investment vehicle such as Vietnam Bank for Development or face to deduction of Government target budgets. Semi-formal microfinance providers are authorized to provide credit but not allowed to accept savings from non-members until they are licensed and the Decree 28/165 comes into effect. [30]

In the traditional BOP market, besides clients who are the poor and low-income earners, demand for financial services is also created by the majority of micro-enterprises which is run by the entrepreneur him or herself with help of the household members. These micro-enterprises are defined as enterprises with a monthly revenue of VND 6-40 million (USD375-

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[30] ADB: report on microfinance industry in Vietnam 2008.

3,750) and employing less than 10 staff. Many of micro-enterprises don't register business, they operate as business households. However, unlike commercial finance (including corporate, private and/or large enterprises finance) or small and medium enterprises which are considered as the engine of the economy and always are cared and offered by commercial banks. These business households find difficult to access to credit and other financial products from formal or semi-formal microfinance providers due to not being qualified as the "poor" and unable to provide collateral as lenders' requirements. Informal money lenders are willing to offer finance to them but always at the interest rate that may jeopardize their business.

3.5   MICROFINANCE DEVELOPMENT IN VIETNAM

3.5.0   History of Vietnam's Microfinance

The development of microfinance in Vietnam can be divided into 3 stages: original, expansion and in-depth development

a) Original stage: (before 1980)

According to conventional definition, microfinance was understood as small loan at free or high interest rate, with or without collateral. With this meaning, microfinance in Vietnam emerged and existed in Vietnam long time ago and very popular in the country particularly in the country-side under the form of small agriculture and daily village affaire of Vietnamese people. While its contribution to the economy is limited, it plays a big role in assisting household and people overcome their adversities and difficult lives.

b). Expansion (from 1990 to 2000)

Since the end of 1980s, along with Doi Moi "Renovation", microfinance has officially entered into Vietnam. During this robust economic growth, with rising income and dropping poverty

level, demand for financial services has increased rapidly especially in rural areas where are the homes of around 80% of Vietnamese population including lower income households as well as the poorest ethnic minority. In the beginning, microfinance was introduced to Vietnam through international organizations, international non-government organizations, and official bilateral and multilateral international development assistance programs. Although, all these programs have the same objectives of hunger eradication, poverty reduction, and income equality, their operation methods are greatly various. Some projects only aimed at providing microfinance services while other projects implemented broader programs in which microfinance taken as a component together with many other social activities. There also existed some programs in which microfinance was considered as a social tool to support a residential unit in a certain period of time. The microfinance sector developed with a strong support of Vietnamese Government because of the fact that the Government has used financial services for the poor as a strategic tool in poverty alleviation particularly in rural areas. Through State-owned banks, the Government channels subsidized loans to poor households to achieve poverty reduction objectives. However, at that time the benefit of credit to the poor had been exaggerated so that the importance of other services like savings, payment service and insurance have been underestimated. Both the Government and non-governmental programs focused on providing credits and its coverage targets to response to perceived unmet demand for credit of the rural poor but paid less attention to the quality of the financial debts, the repayment capacity of borrowers as well as the sustainability of microfinance providers. Increasingly, however, more market-led arrangement has developed.

Almost Vietnam financial intermediaries were established in the 1990s to fulfill the task authorized by the Vietnamese Government i.e. provide micro-credit, subsidized rural credit except the Vietnam Bank for Agriculture and Rural Development which was set up in 1988

with the first named as: Vietnam Bank for Agriculture (VBA). Immediately after establishment the bank was geared to be market-oriented in order to be sustainable and sufficient in providing agriculture-focused financial services. By 2003, VBA was transformed to a fully commercial bank with the new name of Vietnam bank for Agriculture and Rural Development though it still remains focus on rural households and agricultural small and medium enterprises. It is considered as the biggest commercial bank embarking on rural area market with an extension network throughout the country. The bank provides subsidized rural credit through individual lending and joint-liability group, using conventional banking methods VBARD also worked with mass organizations such as women's union or the famer's union to deliver microcredit to its clients. Even if VBARD doesn't target directly the poor, it is estimated that 47% of its clients are the poor.

The People's Credit Funds (PCF) were set up in 1993 after the collapse of traditional credit cooperatives whose main purpose was to collect small deposits and provide credit to individuals, farm households and business and production cooperative. At that time, the target of PCF just aims at mobilizing savings from members against the credit-focused public banks. The Central Credit Fund (CCF) was also established to act as the PCFs apex institution and provided support to the local PCFs. In 2013, the Centre People's Credit Fund was transformed into the Cooperative bank. The new bank operates under the Credit Laws and the supervision of State Bank of Vietnam.

In 1995, with concerns on the exclusion of the poor and other target groups from the commercial operations of VBARD and PCF, the Government decided to directly intervene in microfinance market by creating Vietnam Bank for the Poor which was administered by VBARD. In 2003, Vietnam Bank for Social Policy was established based upon the re-organization of the Bank for the Poor and separation from VBARD for the purpose of

detaching policy lending from commercial lending. From that date, VBSP has risen as the most dominant player in microfinance market.

After the reforms in the late eighties, the Hunger eradication and Poverty Reduction (HEPR), launched by the Vietnamese government in 1998 focused on improving poor people's access to financial services, especially in rural regions. This plan was considered as a framework for integrating poverty reduction efforts targeted at poor households and poor communes.

Besides, Vietnamese Government also encouraged the creation of semi-formal microfinance institutions and the implementation of microfinance programs through socio-political organizations such as Women's Union, Labor Union, Farmer's Association, Veteran's Union etc. Among them, Women's union is the largest union, pioneering in the field of microfinance activity development and attracting a lot of projects funding for microfinance. It has been one of the only legal partner for international non-government organizations and programs wishing to provide microfinance services in the country. To develop toward the professionalization, some social fund started to specialize in microfinance such as TYM fund which was established by Vietnamese Women's Union or CFP Fund founded by Hochiminh Labor Union.

Also in the 1990s, the international development agencies of some countries like Sweden (SIDA), United Kingdom (DFID), Belgium (BTC), the international development organizations such as UNDP, UNICEP and many international non-governmental organizations also coordinated with mass organizations in carrying out saving and credit project. Microfinance models funded by those organizations are diversified due to several kinds of purposes and implementation methods. After being transferred to local partner, some projects have upgraded their legal status to become independent organizations with main activities of providing microfinance service. Although their operations face difficulties because

of legal limitation applying for non-profit organization models, international organization in Vietnam play an important role in laying the foundation and developing microfinance model in Vietnam.

c) In depth-development (from 2000 to present)

In 2002, the Vietnam Living Standards Survey indicated that VBP was the leading microcredit provider to poor households in rural areas with 58% of the market, followed by VBARD with 24%. PCF had a 3% market share of the rural credit market, while semi-formal organizations had a 7% share.

By 2003, the formal financial sector (VBARD, VSPB, PCFs) reached approximately 7 million households, among them 3 million rural households, representing over 90% of the outreach of rural financial services in Vietnam

Until 2005, there are about 40 semi-formal organizations which were formed mainly through the Credit and Saving Program or by Mass Organizations; the other 10 organizations were set up later. These semi-formal organizations allowed to continue their operation in their current unregulated form under the transition provision of the new credit institution Laws. However, all of them when having enough of necessary conditions need to apply documents to transform into regulated form or integrated with the top performer especially when they are in the same mass organizations. In 2010, the first Vietnam's licensed Microfinance Institution TYM was operational. December 2012, M7-MFI was the second microfinance institution which was officially licensed by the State Bank of Vietnam. On 22/08/2014 Fund Thanh Hoa Poor Women (FPW) is officially granted a license. Many of them such as: MOM, CFP, Binh Minh/SED are on the process or completed the requirement of State Bank of Vietnam for Microfinance Institution licensing.

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Today, in Vietnam's microfinance sector, besides Microfinance Services Providers (MFSPs) there is an emergence of Microfinance Support Service Providers (MFSSPs). They are institutions that provide non-financial support services like technical and training services to develop and strengthen the capacities of microfinance services providers such as Vietnam Development Information Center (VDIC), Microfinance and Community Development Institute (MACDI), Community Finance Resource Center (CFRC), Microfinance Working Group (MFWG). While there are very few providers of these training, the MFIs and donors are encouraged to take advantage of the above listed providers for their respective capacity building offerings. At present, most MFIs are still conducting their own training which seemed to be inefficient and quality is not assured.

3.5.1   The Role of Vietnamese Government in Microfinance

Unlike in other economies with deep microfinance penetration, such as Bangladesh, Indonesia, and India, in Vietnam, microfinance institutions are characterized by government control and subsidies.

Vietnam's microfinance system consists primarily of state-owned-directed institutions disbursing loans and collecting savings with the assistance of mass party- or connected organizations for women, farmers, youth, and veterans. These mass organizations are affiliated with the Government but operate mostly independently, such as the Vietnam Women's Union (VWU) and Vietnam Farmer's Union (VFU), have nationwide coverage and manage much of the microfinance delivery process. For example, the VWU administers one-half of Vietnam Bank for Social Policy (VBSP) loans and collects the interest. (VBSP staff collect only the final payment of principal.)

On 16 June 2010, after almost a 3-year top level deliberation on earlier drafts, a new Credit Institutions Law was finally passed. According to assessment of Asian Development Bank (ADB), this landmark legislation -not seen even in countries with major advances in microfinance-that integrates microfinance as a subset of the financial system where it rightly belongs. The new CIL allows negotiated interest rates between lender and borrower and no longer refers to a "base rate", giving liberation of interest rates in the financial market. Its broad coverage of microfinance and the general application of prudential standards of governance to the operations of key institutional microfinance players such as formal MFIs, people credit funds and cooperative banks, set the enable legal and regulatory framework for developing a robust, sustainable and responsive microfinance sector in Vietnam.

Under the new credit institution law, VBARD, people credit funds, cooperative banks and the licensed microfinance institutions will operate under the supervision of the State Bank. This will resolve issues of lack prudential and internal control standards. Other microfinance programs and projects of political organizations, socio-political organizations … that were implemented prior to the Law will be allowed to continue their existence and operation until they could be transformed into formal institutions or otherwise will be merged into big and effective ones especially when they are in the same organization system. This movement showed that Vietnam Government en visions a diversity of microfinance service providers offering a range of quality financial services to low income households, help avoid sudden disruption of these programs and projects and at the same time create a reasonable transition period format or numbers of effective semi-formal microfinance institutions into formal ones to avoid two-tier system of regulated and unregulated credit institutions. A concern is that Government neither has the capacity to carry out an SBV-like supervision of the entities under transition nor should it develop such.

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MFI in transition need learn to be familiar with internal control, audit standard of formal credit institutions to ensure their viability and effectiveness as well as incentives or measures from Government to promote the consolidation and merge of the many small and weak MFIs. According to ADB, having a few but well trained, well-resourced and focused MFIs is a much better option than having many weak ones with little prospect to be sustainable.

On December 6th, 2011, the Prime Minister signed Decision No. 2195/QD-TTg approving the Project: "Building up and developing the microfinance system in Vietnam to 2020". This is an important basis for the development of microfinance in Vietnam in the near future.

Vietnam for Microfinance Committee was re-established under the Decision No. 381/QD-TTg dated 18/3/2014 of the Prime Minister. The Department forms a Permanent assisting group including a number of officers and experts participating in providing policy advice and coordination to the work plan of the Vietnam Microfinance Development Strategy 2011-2020. The policy targeted on the development of an inclusive, responsive and sustainable microfinance market.

In 2014, besides granting official license for Thanh Hoa Fund (FPW), Credit Assistance Fund of the Women Union, Vietnam is also allowed to pilot social lending fund to provide capital support to poor women by the end of 2014 according to Dispatch No. 1700/VPCP-KTTH dated 14/03/2014 Government Office (CSF)

Specially, the Circular No. 33/2015/TT-NHNN dated 31/12/2015 of the SBV on safe operating ratio of MFIs coming in force since 01/03/2016. This circular is very significant in order to replace the Circular No. 07/2009/TT-NHNN dated 17 April 2009 of the SBV on safety ratios in operation of small-sized financial institutions. The Circular specifies how to determine the minimum capital adequacy ratios, solvency ratios as well as modifications and additions to

some of these points: (i) addition of "Debts of Microfinance Institutions" into the Tier 2 capital portfolio when determining the minimum capital adequacy ratio; (ii) The denominator for determining the solvency ratio is the "Total Voluntary Deposit Balance".

Decision No.20/2017/QD-TTg dated June 12,2017 of the Prime Minister on regulation on activities of microfinance programs and projects. It is the detail guidelines from Government about conditions for registration of microfinance programs and projects, the authority and process of granting and revoking registration certificate for microfinance programs and projects, information changed in the certificate of registration, implementation and organization of microfinance programs and projects, financial regime, cost accounting, accounting and reporting and State management of the operation of microfinance programs and projects.

3.5.2 The market main player

a) Vietnam Bank for Agriculture and Rural Development (VBARD).

Established on March 26th, 1988, and having operated under the Law on Vietnam's Credit Organizations, the Vietnam Bank for Agriculture and Rural Development has been a leading commercial bank to play a decisive and important role in capital investment for the development of the agricultural and rural economy as well as other fields of Vietnam's economy.

VBARD is the biggest bank in Viet Nam in terms of fund resources, assets, number of staff, operating network and customer base. At the end of 2009, total assets of VBARD reached VND 479,000 billion, an increase of 22% compared with 2008; total funding resources reached VND 434,331 billion, and total outstanding loans to the economy reached VND 354,112 billion, of which outstanding loans to agricultural and rural areas was VND 242,062 billion. It is the first bank in Viet Nam to receive and develop foreign projects, especially those of World

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Bank (WB), Asian Development Bank (ADB), and Agence Française de Développement (AFD) and European Investment Bank (EIB). By the end of 2006, 98 projects with total capital of US$3.6 billion had been received (including 12 additional projects in 2006 for US$512 million) of which US$1.1 billion has been disbursed. While VBARD does not directly target low income-earners, these donor-funded programs and targeted credit lines in addition to framework agreements with the Mass Organizations (in particular the Women's Union and Farmer's Union) have provided the bank with a substantial rural credit portfolio also reaching LIHs. Since 1995, VBARD has reoriented from lending mainly to State Owned Enterprises (SOEs) to lending mainly to households (HHs) and individuals. In 1993, 30% of its lending was to HHs, rising to 68% in June 2001, but declining to 58% in December 2005 and 2006. In 2009, about 70% of the total outstanding loan is in agriculture and rural areas. The removal of government restrictions on interest rates in May 2002 has enabled VBARD to operate on a more commercial basis and has increased its profitability in recent years. By the end of 2009, VBARD reached 4,2 million customers, of which 4,1 million are active borrowers, making VBARD ranking the second provider among the financial institutions providing microfinance services (savings, credit, money transfers etc.) in rural Viet Nam. However, the policy that institutions are required to provide loans at subsidized rates to households living in remote (Zone 3) areas continues to restrict the commercial operation of formal financial institutions, including VBARD. While the subsidies are funded by the Government, reimbursement is reportedly delayed, which may have reduced VBARD's incentive to expand lending in remote areas. However, as an agricultural bank, VBARD has specialized in lending to rural households and SMEs involved in agriculture or off-farm enterprises. In regard to VBARD's clients, 40% of its clients borrow from 5 to 10 million VND. However, outstanding loans of loans with less than 5 million VND only gained

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VND1,375 million, making up 0.38% and loans with less than VND 35 million, they gained 12.52% of the total portfolio. Loans below VND 10 million do not require collateral if the applicant is sponsored by the Women's Union or the Farmer's Union. Loans above VND 10 million require collateral. Loan terms are typically 6 months, and renewable for another 6 months. Interest rates range from 0.8 to 1.2 percent per month, depending on the current market rate. Repayment formulas vary from lump sum to regular installments. Debt rescheduling is not uncommon, but a higher interest rate applies to arrears.

b) Vietnam Bank for Social Policy (VBSP)

- VBSP was established in 2003 as the transformation of Vietnam Bank for the Poor. The non-profit bank VBSP took over small scale policy lending programs managed by stated-owned commercial banks and other state agencies (Ministry of Planning and Investment, Ministry of Labor, Invalid and Social Affairs, People's Committee at all level…). Thus, the current goal of bank is to offer full range of financial services to the poor households and individual or organizations who are eligible to social benefits and policies at preferential terms and subsidized rate. VBSP is exempted from banking regulations but is required to submit financial and other reports as requirement of State Bank of Vietnam. With head quarter in Hanoi, the bank has branches in all 64 provinces, 600 transaction offices at district level and 8500 mobile transaction points with more than 7,819 staffs and covering around 99% of the total communes in Vietnam.

- There are two lending methods in VBSP: for not-so-poor household borrowers, VBSP's staff directly carried out all credit processes from approval, documentation, loan administration, collection and remedial management. For poor households and

other lending groups loans are released through the Credit and Saving Group. In 2009, VBSPs reached 5.09 million household borrowers from 197,507 Credit and Saving Group. Of the total Credit and Saving Groups entrusted by VBSP, 93% are affiliated with either Vietnam Women's Union (42%), Vietnam Farmer's Union (37%) and Vietnam Veteran Union (14%). For poor households, the maximum loan without collateral is VND7 million (around USD 450) and VND 10 million (USD650) maximum with collateral. The interest rate is 0.5% per month and 0.45% in difficult and mountainous regions. Repayment are made monthly, or quarterly depending on negotiations. For small loan, the loan principal is due at the end of the loan.

Chart 13 : Outstanding loan through mass organizations
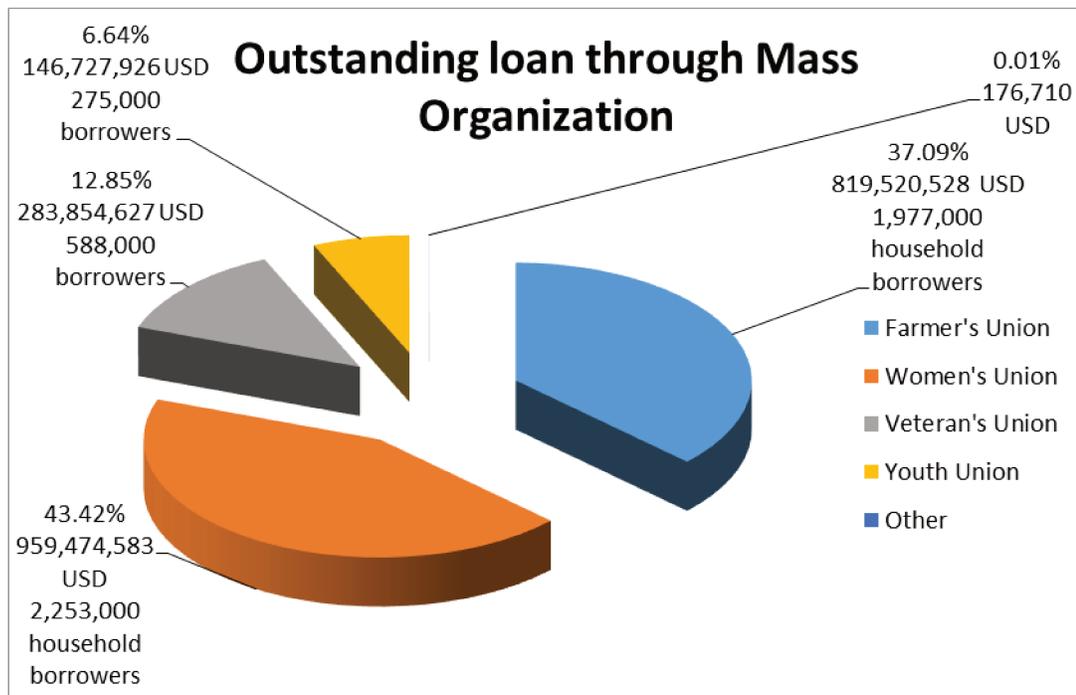
- Total outstanding loan in 2009 amounted to 72.66 trillion VND (USD 3.97 billion) from 10.34 trillion (USD661 million) in 2003 or annual average increase of 83%, in which 82% were to the poor household (44%), student's loan (25%) and loan to

business in disadvantageous are 13% while 18% represented loan come into the other 14 lending program.

Chart 14 : Outstanding loan and saving in VBSP
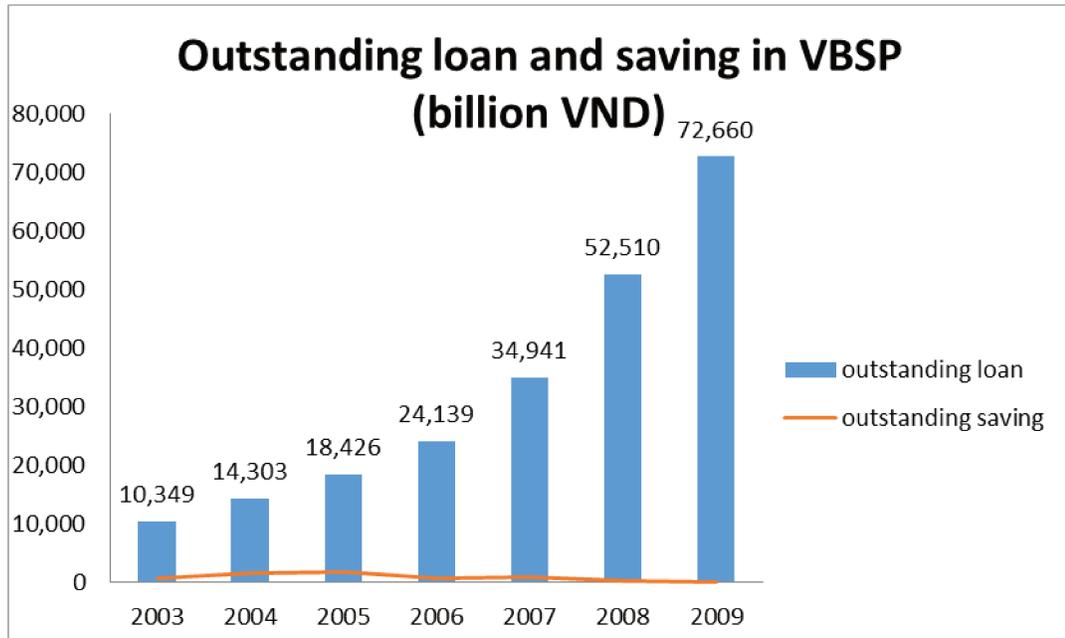
- The outstanding saving value of VBSP is very low because almost products are product policies with undiversified and low interest rate. In fact, VBSP is not a bank with enough basic banking operations. Its deposit rate is not attractive as commercial bank and it is known as special financial institution to conduct tasks of providing social credit to the poor mandated by the government. Therefore, the bank has a weak and deficient saving mobilization with a continuously sharp decrease: saving value in 2009 reached 28 billion VND, decrease -91.25% in comparison with the value of 637 billion VND in 2003.

c). People's Credit Funds (PCF)

- People's Credit Fund was established in 1993, organized into two management levels (Centre and local levels). The Centre People's Credit Fund acts as an apex institution to support and strengthen the operation of local People's Credit Fund. In July 9 2013 it was transformed into Co-operative Bank (Co-op Bank). The new-formed bank will continue its responsibility to develop and supervise banking services for the system of people's credit funds. The Co-op Bank is different than other commercial bank because it was set up by voluntary members who contributed capital in accordance with legal regulations. Like many other microfinance institutions, the new bank and its system target to serve disadvantage people, low income earner and small enterprises while limiting loans with high interest rate and ensuring social security and sustainable poverty reduction. They help also to contribute to the development of the collective economic sector. Like its previous Centre People's Credit Fund, the new bank provides loans to local PCF and non-PCF members at market rate with the capital fund from domestic and international sources. For PCF member, when having demand, they can get traditional loans and loans against deposits or equities with interest rate at 1.25% per month and 15% per year from the centre bank. These loans can be either short term (less than one years) or long terms (from 1-5 years). For non-PCF members, they have to borrow with higher interest rate than PCF member ranging from 15-18% per years. In 2009, the PCF network borrowed from its centre fund the amount of VND2,985 billion (or USD161.39 million), represented for 14% of the PCF's network assets. The maximum a PCF can borrow from its centre fund is up to 50% of the PCF's total loan outstanding. This prudential cap may limit the ability of the PCF to leverage its equity to fund more loan and thus improve its ability to lend greater loans to its membership, improving its profitability. Besides, offering loans,

the centre bank will continue its partnership with other financial organizations such as Western Union and Bao Viet insurance Company to provide remittance services or non-life insurance products.

- The system of People Credit's Funds: as of 2009, the number of People's Credit's Funds is 1,037 with the total number of PCF network of 1.50 million or an average of 1,449 member per PCF. The network's total assets stood at VND21,176 billion (USD1,145 million) from VND83,675 million (USD8million) in 1994, increasing an average of 3.9% annually. Outstanding loan in 2009 stood at VND18, 618 billion (USD1,006 million). Loan portfolios are generally diversified covering agricultural production, processing crafts, services, consumption, trading…Deposits from clients reached VND15,368 billion (USD831 million) in 2009. For PCF, it is challenging to mobilize saving for lending operation because its external borrowing sources is usually scarce and confined operation area in one commune/ward, leading to solvency management is more serious. There are many PCF branches with outstanding deposits of less than 50% of total capital sources.

d). Semi-formal Organizations.

- The semi-formal microfinance providers are non-bank institutions including Mass-Organizations, Non-Governmental Organizations and the credit component of National program for poverty alleviation. They are authorized to provide financial services but not allowed to mobilize capital from non-members. It is estimated that around 57 international NGOs are supporting microfinance activities in Vietnam. In addition, there are two major Government-related microfinance organizations: the Compassionate Fund (TYM) set up by Vietnam Women Union in 1992 and the Capital Aid Fund for Employment of the Poor (CEP) established by the Labour

Confederation in HoChiMinh in 1992. They are also the two leading microfinance institutions in Vietnam in terms of size and performance. In 2010, the Compassionate Fund (TYM) was licensed to transfer from unregulated microfinance program to formal regulated microfinance institution in Vietnam under the new microfinance regulation (Decree 28/165).

- In comparison with formal microfinance providers, semi-formal players don't have large network nationwide, and limited outreach. They have their presence in 36 provinces (57%), 132 districts (23%) 2,900 communes (27%) of the country and reached nearly 500,000 clients, mostly are poor and the poorest households. To expand their outreach and operation, these organizations usually rely on a limited pool of international donor funding because until now they are still not allowed to access commercial funding. However, they have their certain advantages: having more international experiences coming from NGOs, their operations are closer to best practices of the world microfinance and they provide wider and more appropriate range of finance services to the poor than formal sector. Besides credits, there are only semi-formal MFIs apply compulsory savings among their members to maintain cooperation and responsibility. The savings amount is subject to regulation of each organization and usually follow loans (1-5%) or the monthly absolute contributed value (VND 3-10 thousand)

Table 11: Outstanding loans and savings of some semi-formal MFIs as of 2009

Name	Cotmpulsory saving (VND million)	Voluntary saving (million)	Total capital sources (million)	Ratio of savings/total capital source (%)	Total outstanding loan (million VND)	Ratio of outstanding loan/total asset (%)

TYM	32,483	1,446	176,526	19.22	140,174	64.95
CEF-HCM	97,588	10,553	424,408	25.48	388,230	91.48
FPW-Thanhhoa	0	1,814	10,958	16.55	19,340	85.01
Binhminh-SEDA	2,212	135	11,298	20.77	12,490	85.08
PYKT-HCM	3,207		35,632	9.00	n/d	n/d
MFI-Tuyenquang	4,352		40,585	10.72	38,222	94.18
Fund for poor women- Hatinh	8,606		55,672	15.46	51,341	92.22
Vietnam-Bilgeum	21,009	3	69,350	30.30	59,416	85.68

Source: MFWG and survey results of researchers group in MFIs

- The compulsory savings is much bigger than voluntary savings. However, the compulsory savings ratio only makes up around 21,4% in total capital source. There is no legal regulations from Vietnam Banking System on compulsory or voluntary deposit when borrowing but it is very important for microfinance operations because this is a measure to encourage formulate saving habits and prevent risks in poor community. While semi-formal providers provide a full wide of credit products, most clients start out with basic short-term loan from VND200000 (USD6.5) to VND 5 million (USD300). Interest ranged from 0.9% to 2% a month, higher than the one of formal commercial bank. That is because of the fact that almost semi-formal organization are exempted from the State Bank's regulations on interest rate except some National Credit programs, thus they can set up their interest rate higher in order to cover their operation costs. The loan term varies from 6 to 12 months but never exceeds 24 months. Repayment can be made on a weekly, or monthly period

Box 3: **Vietnamese microfinance organizations vs. their global peers – nine fast facts**

The "typical" microfinance organization (MFO) in Viet Nam differs in many ways from those elsewhere in Asia or the world, as benchmarked by the Microfinance Bulletin. Below are nine of the most salient points that make Vietnamese MFOs unique:

1. They are not privately owned. Due to the absence of a legal framework for MFIs and the 'Viet Nam-specific' role that mass organizations have, all MFOs in Viet Nam are owned by public or semi-public entities, even if independent management boards may be in place. Licensing under Decrees 28/165 will legalize private ownership structures, which commercial investors in general prefer.

2. They are small. They have fewer clients and smaller loan portfolios than their international peer MFIs. Their average number of clients is half the global average of MFIs and one-third of the average for Asian MFIs, even at similar age. Their average loan portfolio is one tenth of the international average for MFIs.

3. They have lower (recorded) expenses, both in terms of operational and financing costs, than their international peers. This may be because Vietnamese MFOs receive a number of implicit subsidies from the Women's Union ranging from free rent to heavily-subsidized credit officers' salaries.

4. Because the costs are lower, Vietnamese MFOs are better able to cover their (reported) expenses than international MFIs (as measured by OSS).

5. They are more poverty-focused by having a smaller loan sizes than their international peers (relative to the per capita income of the country).

6. They lend almost entirely to women – unlike many MFIs outside Asia.

7. They generally do not borrow, like their foreign counterparts. They are funded almost entirely by donations, equity, and savings. This reflects the absence of microfinance regulations that permit borrowing and may change with Decree 28/165– although many Vietnamese MFOs may be too small to attract lenders.

8. they charge lower interest rates, as measured by their portfolio yield (nominal). As a result, they only have around half to one-third of the revenue/assets of their international peers. This may be because of the competition from the subsidized lender VBSP, or because

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> *lower (reported) expenses allow MFPs to charge lower interest rates while still covering costs.*
>
> *9. Credit officers are more productive, with a higher caseload for credit officers. This relates primarily to the prevalence of group lending products among Vietnamese MFOs, but may also be partly explained by the relatively high population density in Viet Nam (particularly in some rural areas) and by the fact that client monitoring activities are often done by*
>
> *Women's Union staff on behalf of or as seconded staff to the MFO.*
>
> This table is based on an upcoming article by Steven Penning, Save the Children/US-World Bank: Vietnam Microfinance Report

e) Informal Microfinance Providers

- So far, the formal financial sector cannot fully meet rural households' demands for loans, leaving a large berth for the informal credit market to operate. Before the eighties until the nineties, loans from informal sources (e.g., moneylenders, ROSCAs, friends, relatives and other private individuals) represent around 70 percent of total loans[31]. It is believed that many households borrowing from the formal sector also borrow from the informal sector so that the 1998 survey reported the informal sector could still represent as much as 30 percent of total loans despite the great efforts to improve credit provision to rural areas. The main advantage of informal credit supplier is generally convenient and locally based with simple transaction procedure and loan can be applied for consumption purposes. However, while friends and relatives provide loan with free-interest, most private informal lenders charge interest rate up to three times higher than interest rate from the formal banks.

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[31] The result of Vietnam Living Standard Survey in 1992

+ Private Money Lenders:

Moneylenders are usually the better off in the same community with borrowers, they have rich pocket of money or goods and know quite clearly about the borrowers. They are always available to provide small-scale credit on range of terms (seasonal, daily) for borrowers whenever they receive demand from their clients. In fact, there is no data on the number of people using this kind of credit but it is very popular especially in the Vietnam's rural areas where people know the family living situations of each other quite well and correctly. This credit method is very simple and made by a writing papers between creditor and borrower certifying a credit transaction is carried out with the signatures of the two. The main features of moneylenders are that they observe a market approach in providing credit and negotiate for a high rate with payments made on a monthly basis around 3-10% per month (Dao, 2002). The service is flexible but bearing a high opportunity cost.

+ ROSCAs: (Ho, Phuong and Hui)

- Ho: The name means Relatives or Friendship and originates in the North of Vietnam. It isa traditional small credit group from 5 to 20 members, organized by local people. The members often have the same career e.g. groups of farmers, groups of traders, groups of war veterans etc. Each group operates as an independent organization having no relation to other groups or to formal institutions. A group leader is elected by members to collect deposits and keep records. Members deposit savings are used to form funds, which will be lent to each group member in rotation. Savings can be in cash, paddy or gold. The amount of monthly cash savings depends on the agreement reached within the group.

- Phuong: Phuong does not charge interest on loans. Each member deposits required periodic savings and is entitled to receive an interest-free loan once in a credit cycle. Minority groups in mountainous areas, where interest-bearing loans are not considered a friendly way to

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help each other, favor this approach. The groups are smaller than in the Ho, varying from 5 to 8members. One may understand this mechanism as a rotating savings and lending group.

-   Hui: The name of Hui originates from the South of Vietnam. The Hui has operated somewhat like a Ho in the north. Unfortunately, many members borrowed as much as possible by offering incredibly high interest rates (5 to 20 per cent per month). The loans were used to invest in land, trading or assets for speculative purposes. Such investments earned a high return during the boom 1985-98. However, it ended because some members even borrowed from one person to repay the other, anticipating that the future returns would cover all debts. Many Hui collapsed (VO HUI) as borrowers lost the ability to make repayment. As a result, Hui is now considered as "cheating credit" in Vietnam.

+ Borrowing from relatives and friends; Credit terms are flexible depending on the relationship between creditors and borrowers and on the availability of extra income sources with free interest rate. The Vietnamese culture dictates that one should help poor friends or poor relatives by handing over the money rather than lending it to maintain good relations.

3.6   CHAPTER CONCLUSION

The chapter presented a country profile of Vietnam, an overview of recent developments in the country and the global environment within which microfinance operations. Thanks to the great supports of Vietnam Government, microfinance in Vietnam has been established and gradually become part of the national financial system. There are many advancements in the legal and regulatory framework that help open a window for the creation of licensed MFIs however, participation by private sector in this field is limited. The Vietnam Government still has the tendency to see microfinance as social tool to combat poverty and directly intervene in the provision of microfinance services with the targeted policy lending and interest rates subsidies

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through operation of Government poverty-reduction Fund for Vietnam Bank for Social Policy. That movement of Government keeps creating un-even playing field in microfinance sector. Dominance of large stated-owned microfinance providers and the popularity of target lending at subsidized interest rates have efficiently kept the level of non-state microfinance lending low. Although semi-formal MFIs seems to be active and efficient in rural areas, they still have relatively small clients-base. They operate not under the supervision of Vietnam's State Bank but heavily involve with non-financial mass organizations. Therefore, they are affected by pressures from mass organizations rather than economic incentives. The operations of microfinance in Vietnam will be analyzed thoroughly in next chapter in comparison with microfinance in other benchmark countries so that we can assess what will be the factors that could motivate or hinder the growth of the industry.

CHAPTER 4

COMPARATIVE ANALYSIS OF FINANCIAL INNOVATION BETWEEN VIETNAM MICROFINANCE AND SOME OTHER INTERNATIONAL BENCHMARKS

4.0   INTRODUCTION

The appearance of microfinance has been a panacea for many social ills rooted in poverty. However, it is not a standard solution in the kind of "one size fits all" to worldwide underdevelopment and poverty. As the concept of "one political state, one language and one culture" which has been existing and theorized long time ago since the birth of a nation state in French revolution, each country has its own socio-economic-political-legal context, a unique culture, a distinctive dominant ideology, a special set of values and a governance structure, thus, poor people there have to face different poverty demands with diversity challenges and threats. In the beginning when microfinance just emerged, most governments acted the same as actively supporting the survival of microfinance through lending programs with direct or indirect subsidies. However, the rapid development of microfinance sector as well as the new transition of microfinance toward profitable commerce have led to microfinance mission drift and encountering national financial regulators' opting between two approaches: microfinance for the social development target or microfinance for profit. Basing on their highly contextual development with participants of both internal and external concomitant as well as the financial demand of the poor in each country, States decided their own development approaches, framed suitable microfinance institution models, tried to integrate portion of microfinance spectrum into their respective regulated financial sectors. In the last four decades, microfinance has spread across most continents with various models as per local needs

including associations, bank guarantees, community banking, cooperatives, credit unions, Grameen, group, individual, intermediaries, non-governmental organizations, small business and village banking models. Microfinance in Vietnam with its distinguishing characteristics such as rural-based microfinance, involvement of socio-political organizations in microfinance and State-supported Policy lending bank is now in the evolution process of transforming from unregulated into regulated institutions toward a sustainable inclusive finance system. It requires a dynamic innovation and a complete understanding of microfinance evolution to know what should be the suitable conditions for development, what could shape its growth and what factors constraint it. Although it is impossible to build a unique development formula for all microfinance institutions, it makes sense to consider some successful practicing benchmark models in some developing countries in Asia area to shed light on the changing field in Vietnam and identify the conditions that limit the scale and scope of microfinance activities in this country. Keeping that in mind, in this paper we undertake Grameen Bank model in Bangladesh and village banking model of Bank Rakyat in Indonesian (BRI) as case studies to make comparative analysis with the microfinance system in Vietnam in term of financial innovation and methodology. The Grameen Bank and the BRI are chosen for this analysis because these two countries and Vietnam are developing countries in the Asian area that has been called "a cradle of microfinance" by the World Bank with a large potential demand for microfinance in rural areas. Moreover, the two banks are the two greatest successful benchmark representatives for the two microfinance approaches: Grameen Bank is the first leading microfinance bank in the world focusing on developing sustainable microfinance for poverty alleviation; whereas, Bank Rakyat, Indonesia is the world largest sustainable commercial microfinance system, the first evidence of developing microfinance for profit target. The presentation of cases can't be fully comprehensive. Rather we intend to take

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selective business approach, focusing on financial innovation and the adaption of microfinance institutions models with institutional environments variance according to the context of host countries, local demands for microfinance services toward safeguarding the sound growth of the microfinance market.

4.1   BACKGROUND OF MICROFINANCE IN THE THREE COUNTRIES

The model of microfinance in Bangladesh as it originated at Grameen Bank is characterized by tiny loans to women with fixed terms and amounts, group liability, weekly meetings and forced payments into a group savings account. The success of Bangladesh microfinance has been seen in experiences of Grameen Bank which has been well-known all over the world. While many in the microfinance industry and outside equate microfinance with Grameen model, the bank quietly kept innovating itself, re-engineering its model to pursue an expanded vision. The introduction of Grameen Bank II in 2002 marked the most dramatic shift, re-tooling the bank's operation thoroughly with new lending methodologies, products and support services. Today with the innovation, there are a lot of departures from the original model in which the biggest change is the relaxation of formal group liability. Group liability has no longer been used to reinforce loan contracts, instead, they use groups to facilitate interactions with clients and may offer various incentives for peer support. Other changes focused on making microfinance more valuable with clients both in terms of better products and a simple business process. Grameen Bank may be the best example of how a sustainable and effective decentralized structure of competent dedicated lenders could have a positive social impact in the country's most impoverished regions. Microfinance has grown to an enormous scale in Bangladesh with approximately 23 million borrowers in the country for roughly 150 million people. These high numbers reflect merits of microfinance in both social and economic

contexts of Bangladesh. While Bangladesh develops microfinance with social development targets, Indonesia was one of the first countries to develop commercial microfinance in Asia with regulated financial institutions providing the bulk of microfinance services in which Bank Rakyat Indonesia units are dominant actors, receiving two-thirds of savings mobilized in the formal and semi-formal microfinance sector. BRI is the oldest commercial bank in Indonesia which was stated-owned company until 2003 when it listed 30% of the shares on the Indonesian Stock Exchange (IDX). From a government-owned agricultural development bank, BRI made good use of government seed money and the World Bank loan during an initial phase and could be transformed to be the country's second largest lender by asset and the largest sustainable microfinance network in the world. Its business focuses on providing carefully crafted micro-savings and microcredit products to low-income people at market rates of interest. It also has a comparatively small, but growing, corporate business. With an outreach of 50 million saving accounts and 25 million borrowers through a network of more than 10,000 outlets operating real time online covering both urban and rural areas, the bank can cover its costs from the interest rate margin and finance its expansion from its profit. The bank can create an easy access for their poor clients to their financial services without any credit bias and at the same time mobilize their savings cost-effectively, making an increased volume of loanable fund by exceeded-wide margin between the demand for deposit service and the demand for credit. Their smart incentive financial policies, and motivated staffs together with continuously effective innovations in internal management and supervisions helped the BRI Micro-Banking Division weather the Asian financial crisis well and became a unique profitable bank every year since 1986 even during the crisis years of the late 1990s when the country's financial system collapsed.

In comparison with Indonesia and Bangladesh, microfinance sector in Vietnam appeared later thanks to the influence of global micro-finance development. It emerged during a period of national robust economic growth since 2000 and has grown rapidly. Demand for financial services has increased with rising incomes and dropping poverty levels. Vietnam lowered its poverty headcount from 58% of the population in 1993 to 37% in 1998; 29% in 2002; and as low as 24% by 2004, meaning that one third of the population has been lifted out of poverty during this period. However, poverty was different between rural and urban areas, between the two genders, among economic regions, ethnic groups, and groups categorized by their educational levels. Poverty was reduced in a much slower pace in the central region, the poorest in the country and northern mountains and the north central coast while the proportion of ethnic minorities in the overall poor population increased representing an existing huge demand of microfinance in rural areas, especially in remoted mountainous areas. Vietnam's current microfinance system, although extensive in most recent years, has been still shallow penetration. Government uses a dual approach that is both market-based and state-driven to ease the financing constraints of poor and rural households. Targeted policy lending with subsidized interest rates remains substantial in the country's microfinance sector through operation of government poverty-reduction funds under the Vietnam Bank for Social Policy.

4.2   RESEARCH METHODOLOGY

This chapter uses cases qualitative comparative methodology (QCA). It is a method that bridges qualitative and quantitative analysis. QCA provides powerful tool for access and analyzes causal complexity by interpreting qualitative data whilst also looking at causality. For QCA, in this article, we collected a broad range of secondary data from many online sources such as annual reports, international organizations documents, survey results from other related

researches, online data to reviewed and analyzed in case studies and then make comparative analysis to fulfill the research.

4.3 CASE STUDIES

4.3.1 Grameen Bank

History of the Bank

- From an action project to bank.

The origin of Grameen Bank can be tracked back to 1976 when professor Muhammad Yunus, head of the rural economics program at the University Chittagong, launched an action project to examine the possibility of designing a credit delivery system to provide banking services to the poor in rural areas. The objectives of the project were to "extend credit to landless poor men and women, to eliminate the exploitation of moneylenders, to create opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh; bring the disadvantaged, mostly the women from the poorest households, within the fold of an organizational format which they can understand and manage by themselves; and reverse the age-old vicious circle of "low income, low saving & low investment", into virtuous circle of "low income, injection of credit, investment, more income, more savings, more investment, more income" (Yunus, 1982; Grameen Bank, 1986, Rahman 1993)

The project was piloted and gained good results in several villages in Chittagong and, over the period 1976 to 1979, demonstrated its strength and viability. With the collaboration of Bangladesh Central Bank and other nationalized banks, the credit project was extended to Tangail District in 1979. Success in Tangail led to further extension of the project's services in the districts of Dhaka, Rangpur and Patuakhali. In October 1983, the project was transformed into an independent bank by government legislation. It is called Grameen Bank which in

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Bangla means Village Bank. At the beginning, the government provided 60% of the initial paid up share capital of the bank and the rest 40% procured by the borrowers of the bank. In 1986, the government share capital was reduced to 25% and the rest was from the borrowers. Today the Bank is owned by the rural poor whom it serves. Borrowers of the bank own 97% of its shares, while the remaining belongs to the government (The Prothom Alo, 29 June 2012). GB is the only an organization that provides interest free loans to the beggars.

It is important to realize that the Bank has evolved as the result of a long learning process, Grameen Bank now has nearly 8.4 million members – nearly 97 percent of whom are women – and has lent over $12.5 billion, allowing millions of women and their families the opportunity to lift themselves out of extreme poverty. (Grameen Bank's annual report 2013) As Grameen Bank members gain experience and prove their reliability, they may take out loans for joint enterprises. The loan amounts for joint enterprises are much larger and may be up to USD6500. More than 100 different kinds of joint activities are financed in this way. Most joint loans are for activities in agriculture and forestry followed by activities in livestock and fisheries and the running of mills and factories. Well established Grameen Bank members can also borrow up to USD300 for building a house. House loans are repaid over 10 to 15 years. To date, more than 1800 houses have been built with these loans. All loans are repaid in weekly instalments. The Bank's recovery rate is extraordinary. Close to 98% of its loans are repaid--and on time. (FAO's report, Jamal Nazrul Islam 2012, Grameen Bank at a glance)

The bank has gained its funding from different sources, and the main contributors have shifted over time. In the initial years, donor agencies used to provide the bulk of capital at low rates. By the mid-1990s, the bank started to get most of its funding from the central bank of Bangladesh. More recently, Grameen has started bond sales as a source of finance. The bonds are implicitly subsidized, as they are guaranteed by the Government of Bangladesh, and still

they are sold above the bank rate. In 2013, Bangladesh parliament passed 'Grameen Bank Act' which replaces the Grameen Bank Ordinance, 1983, authorizing the government to make rules for any aspect of the running of the bank.

The bank is also engaged in social business and entrepreneurship fields. In 2009, the Grameen Creative Lab collaborated with the Yunus Centre to create the Global Social Business Summit. The meeting has become the main platform for social businesses worldwide to foster discussions, actions and collaborations to develop effective solutions to the most pressing problems plaguing the world

Financially, the Bank is almost self-sufficient, even running with a small profit. To its members, Grameen Bank is much more than a bank in the conventional sense. Through a variety of programs, it supports activities to improve sanitation, health, nutrition, education, family planning, dowry less marriages and mutual help among its members. The success of Grameen bank has made it become famous over the world and its model has been replicated in more than 100 countries and now benefits tens of millions of others. Successes and potential benefits of the GB micro credit system could be summarized as follows:

- it exhibits an average of 97% repayment rates,

- the members of GB enjoy an average household income at least 25% higher than nonmembers,

- the number of GB members living below the poverty line has rapidly decreased,

- the landless benefit most, followed by marginal landowners,

- there has been a shift from agricultural wage labor to self-employment and petty trading a shift which results in an indirect positive effect on the employment and wages of other

agricultural wage laborers, and which has impacted poverty alleviation and economic improvement at a national level, and

• group savings have proven as successful as group lending.

Organizational Structure of Grameen Bank

At present, Grameen Bank is the largest microfinance bank in Bangladesh and probably the biggest micro credit organization in the world. One of the main factors behind the success of the bank has been the way it is organized and managed. It is purely a bank that provides banking services only to the poor for the target of poverty alleviation but is designed to run on commercially viable terms. It extends credit to the poor to invest in productive sectors such as processing and manufacturing, agriculture and forestry, livestock and fisheries, services and trade. The bank is exclusively for poor people and it is directly owned by them as well. The government has very little material stake in the bank— nowadays it owns only 3 % of the bank and has three nominated members on the Board of Directors (Yunus 2012). Over the years, the bank has evolved its organizational system and associated practices in response to the specific developmental needs of the target clients.

Grameen Bank's organizational structure is highly decentralized. hierarchical and consist of four level of administration and three level of organizing borrowers. The organization is constructed by geography and function. Pyramidal banking structure including lending units, centers, branch offices, area offices, zonal offices and a head office in Dhaka (Latifee, 2008). The Board of Directors consist of 13 members of whom 9 are selected from among borrower shareholders, the rest includes bank's Chairman and other 3 nominated members appointed by the country's Government. This board approved the bank policies and serves as the link between the Bank, the Ministry of Finance and other government organizations. The Managing Director is the chief executive of the bank, taking responsible for the overall implementation of

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the policies and has to maintain close contact with various departmental heads in the head office and zonal managers to assist in formulation and change of policies. In terms of administration, at the bottom of the Grameen hierarchy is the branch office, which is considered the main operational organ of the bank. It is basically a profit-responsibility unit and locate in villages. One branch serves a cluster of 120–150 centers and it has a manager, six or seven workers, two to three trainee workers and an accountant. The branch offices select and organize the target clienteles, supervise credit operations, and recommend sanction of loans. The second tier is the area office, which looks after the operations of about 10–15 branch offices and being assisted by program officers. The area manager works under the supervision of the zonal office that is located in the district headquarter. at the top of the hierarchy of the field level. The zonal manager is responsible for handling accounts and managing funds and has also assumed responsibility for monitoring, evaluating and supervising the social development programs. The head office of GB is situated in the capital city Dhaka. It is responsible for monitoring and evaluation, research and development, supervision of training, and similar activities which are benefited from access to information from different operational areas.

Within this hierarchical structure, unconventional organizational approach stands out. Unlike other commercial venture, the work is not focus on head office. Instead the whole organization focus on the centers, groups and borrowers. The bank applies the philosophy that the bank should go to customers no other ways around. For the target, Grameen Bank execute the customers-base delivery system and strikes to integrate all of its borrowers into the organization, practically making the bank and its clients to be one big organism. All borrowers are required to purchase one share of the bank, becoming bank's owners (97%). In Grameen Bank, trust between staffs and clients is the strong management system to devote all basic

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decisions effectively. All banking transactions are carried out in front of the clients and bank staffs in grassroots levels. Efficient field-based training is given both staff and clients. Clients become a part in the bank's structure as the bottom of the bank's organizational hierarchy and also theoretically the most influent factor in GB's decision- making progress. Widely opened structural boundary of the bank helps bring clients into the organization to monitor and be held accountable for loan and other functions. The Head office only bears a little responsibility except for strategic issues such as basic policy, research and development. Democratic leadership practices are given by the rotation among members of centers and group leadership. The field officers are encouraged to send monthly directly to the Managing Director summarizing different aspects of their works. The Managing Director reviews and public all significant issues, concerns and suggestions in the internal monthly magazines which are reached all bank officers and workers. These methods of communication consider the Grameen Bank's employees as responsive, committed and productive teams contributing to the development of the bank.

Once a year, Grameen Bank rates its branches according to five-star management system in order to give confidence competition and to achieve the objectives of sustainable operation and poverty alleviation. Braches are awarded stars of different colors based on their achievements against following five benchmarks:[32]

- *Green Star*—a 100 percent repayment rate (66 percent of the branches qualified in2003).
- *Blue Star*—profitability (66 percent of the branches qualified in 2003).
- *Violet Star*—deposits exceed loans (33 percent of the branches qualified in 2003).
- *Brown Star*—100% of literacy. It measures by showing all children of borrowers attend school (13 percent of the branches applied in 2003).

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[32] Yunus-Grameen at a glance.

- *Red Star*—borrowers have crossed over the poverty line (4 percent of the branches, which represented more than 125,000 families, applied in 2003).

This kind of rating carried out no financial rewards but Yunus believes that kind of competition created sufficient motivation to foster friendly competition between branches.

Changes in organizational structures

National political crisis and the historic flood in Bangladesh in the late 1990s made the bank encounter some repayment difficulty. So, its managers and staff decided to pilot a number of experiments with new products and new ways of managing service provision in order to stabilize the bank and help poor families to prevail poverty. Members of the bank stopped paying their weekly installments and stopped attending the weekly meetings with bank workers (Dowla and Barua 8, 2006). The changes resulted in restructuring bank's organization. By 2001, Yunus announced the launch of Grameen Generalised Systerm or Grameen Bank II, that is replaced the classical Grameen bank with new range of different terms. The components of the new model were designed so that (i) they should meet client demand, and (ii) they should be profitable for the Bank. Changes that were put into practice in the new Grameen model include (Dowla and Barua 250, 2006):

1. A shift from group loans to individual loans.

2. Development of new products such as the Grameen pension scheme to cater the need of retires.

3. Active campaigns to collect savings from nonmembers to raise additional loan funds.

4. Allowing borrowers to borrow against their savings, unless they have payments arrears.

5. Offering only one loan product, the basic loan, rather than multiple loan products.

6. More flexible repayment schedules-installment size is variable rather than fixed.

7. New branches no longer have to borrow funds from the head office for credit disbursement. They can be self-financed by collecting funds from members and nonmembers.

8. Easing loan terms, saving requirements, and repayment conditions for beggars-the poorest of the poor.

The results have been staggering. The Bank has not only been able to stabilize itself but has, in effect, relaunched itself and its trajectory. While it took Grameen 25 years to reach a client base of 2.5 million, it took only three years, from 2001, to recruit the next 2.5 million clients (Rutherford *et al*., 2006). Over the period 2002 to 2005 the Bank tripled the deposits it held (US$478 million) and doubled its portfolio of outstanding loans. The Bank's loans portfolio became smaller than its savings portfolio. It built up a large fund for bad loan provision and profits rose from 60 million Taka in 2002 to 442 million Taka (US$7 million) in 2005. This growth consolidated for the philosophy that the poor can pay back and the Grameen itself can develop and has capability to manage its assets.

<u>Grameen Bank: Financial Performance</u>

Grameen Bank always reported profitable in every year except three years 1983, 1991 and 1992. Even in the very start up period, its financial margin (about 9 percent of its assets) is high in comparison with other commercial banks (3 to 4 percent). However, the bank has to bear a huge administrative cost of approximately 50% of its total cost while commercial banks must spend 25 to 30 percent of total costs for administration. Therefore, theoretically, to get financial viability Grameen Bank need to gain financial revenue high enough to at least equalize its cost of operations which include administrative cost, loan default cost and cost of raising resources. Before 1993, the interest rate required to break even, given its cost of funds had always been higher than its average on-lending rate, so it can't meet its cost of lending. Only since 1993, Grameen bank has been operationally efficiency. The Grameen's secret of

how to keep continuously positive profit belongs to its on time changes in financial strategy to

guarantee its source of fun

Table 12 : **Grameen Bank's Financial and Economic Viability**

Year	Profits (million taka)	Financial Margin	Salary Cost as % of total	Break even rate of interest	Average On-lending Rate of Interest	Subsidy as % of Loans	Dependency on Foreign Funds (foreign funds as	Savings and Deposits as % of Loans
1989	2.26	9.33	40.83	17.64	12.90	21.12	90.76	29.52
1990	10.22	8.77	42.32	20.34	12.90	21.57	93.57	33.32
1991	11.92	9.20	49.73	22.79	16.50	21.12	94.64	29.50
1992	(-5.65)	9.75	50.02	16.50	16.74	16.80	99.93	31.25
1993	9.56	9.48	44.06	14.85	15.96	11.90	58.12	42.44
1994	21.74	8.43	29.43	16.30	16.51	3.72	3.73	26.13

Note: Figures in parentheses represent growth rates from preceding year. Source: Khandker, Khalily, and Khan (1995).

Table 13 : Trends in profits of the Grameen Bank, 1986-94 (million taka)

Year	Profit			Growth rate of reported profits	Reported profit as percentage of		
	Reported	Revised	Operating		Total	Assets	Equity
1986	0.36	0.36	3.17	-	0.40	0.04	1.01
1987	0.44	-2.56	7.16	22.22	0.34	0.03	0.77
1988	1.17	-32.66	4.46	165.91	0.59	0.06	2.76
1989	2.26	-57.34	5.94	93.46	0.76	0.08	3.13
1990	10.22	-65.46	13.9	352.21	2.47	0.26	14.19
1991	11.92	-61.47	-17.59	16.63	2.16	0.25	10.42
1992	-5.66	-68.03	-23.45	-141.44	-0.73	-0.08	-3.79
1993	9.56	-77.36	-29.50	269.38	0.72	0.08	6.37
1994	21.74	-54.60	-15.11	127.41	1.08	0.13	10.04

Table 14 : Trends in profits of the Grameen Bank, 2002-2011 (million taka)

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total income	2,753	3232	3489	4746	6335	6790	7831	9797	12435	14265
Total expense	2,087	2115	1671	2379	2978	3689	4373	5629	6804	7125
Total asset	22,602	27143	33653	44624	59383	68953	2800	103005	125396	140441
Reported income	59	357	422	1000	1398	106	371	1304	757	683
Operated income	2,146	2473	3112	5109	5959	6133	6542	7429	8513	10686
increase of income		605.08	715.25	1695	2369.4	179.66	628	2210	1283	1157
Profit as % of total income	2.14	11.04	12.09	21.07	22.06	7,58	4.73	13.31	6.08	4,78
Profit as % of total expense	2.82	16.87	25.25	42.03	46.94	2.87	8.48	23.16	11.12	9.58
Profit as % of total asset	0.26	1.31	1.25	2.24	2.35	0.15	13.25	1.26	6.08	4.78

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Return	2.93	10.6	8.98	21.2	25.8	1.79	21.2	5.64	10.7	8.97	17.1	13.6

on equity		3%	%	2%	3%	%	1%	%	4%	%	0%	5%
Operating self sufficiency (OSS)	102.00%	111.10%	109.88%	115.65%	117.41%	101.02%	112.20%	102.63%	104.46%	103.31%	106.17%	105.15%
Financial self sufficiency (FSS)	99.60%	107.88%	105.70%	110.40%	112.28%	94.84%	106.07%	99.21%	99.20%	95.79%	99.62%	99.59%

Before 1993: Being subsidy dependent.

Grameem Bank got its funding from many sources. Before 1993, the Grameen bank's operations depend to a large extent on the availability of outside funds. Initially, the International Fund for Agricultural Development (IFAD) provided most of these funds at a 3% interest rate. Bangladesh central bank also provided matching funds at the same interest rate. Other international agencies such as IFAD (International Fund for Agricultural Development), NORAD (Royal Norwegian Development Cooperation), SIDA (Swedish International Development Agency), ODA (British Overseas Development Agency) and the Ford Foundation also become financiers of the Bank. As of December 1993, foreign sources had contributed 58.1% of total Grameen Bank resources and TK2,886.3 million or 34.5 % of total funds were provided in the form of grants (for revenue and on-lending). Given its access to grants and cheap funds from official sources both foreign and domestic, the bank did not have to use borrowed funds from the commercial banks until 1992. Such inexpensive funding has been a key instrument of the Grameen Bank's phenomenal expansion in terms of organization, coverage and lending. The exceeds of borrowing funds at high concessional interest rate in comparisons with the financial needs of its clients helped the bank earn a vital interest income by reinvesting

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and often arbitrating with these funds. It also helps the bank pay some particular donors' interest. This measure of profit include income from direct grants gives the underestimated views on the bank's true cost of raising resources and shows profit years on years.

In 1992, the bank tried to seek financing in local market through issuing bonds and debentures and that made decrease the indicator of subsidy as % loan outstanding and dependency on foreign fund to 3.7%. However, without the guarantee of Bangladesh's Government, the bank couldn't benefit local fund through bonds and debentures. According to Khandker "when the bank issues bonds in 1995 to generate market resources at the market rate, it had difficulty mobilizing market resources. In that year, all nationalized commercial banks had tremendous liquidity and were eager to buy Grameen bonds, but with the government's guarantee. The Government had to step in and Gramee Bank was rescued for its shortage of liquidity in that year" The bonds and debentures were sold to national banks with the interest rate varying from 4-6% according to the due date years, even lower than the deposit rate that bank offered to its clients and far lower than market rate interest. Assuming an average cost of 5% on bonds and a rate of 9% in alternative safe investments, Bangladeshi nationalized banks (or the Government through its guarantee) implicitly subsidized Grameen in the amount of 258 million taka (USD6.4million) in 1994-1995-about USD3.10 for each of Grameen's two million members [33]. So obtaining fund by issuing bonds and debentures to local market is indeed in some extend to be another kind of Government subsidy that give to Grameen Bank and had help indirectly increasing profit of Grameen bank.

However, reliance on subsidized resources can't be a permanent feature of a financially viable institution. External resources dependence with grants and concessional interest rate brings its

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[33] Research from Jonathan Modurch 1999:. Role of subsidies in microfinance evidence from the Grameen Bank.

external influences (Yanus 1993, Hassan and Guerrero 1997, Khander 1999) and virtual profit due to the economic cost of funds (the opportunity cost) used for credit and other operations is not compensated with the income it generates from lending at market rate. Evidence shows that in 1994 when the bank had to face with big repayment troubles and the extreme slowdown of external funds, the long- term survival of the bank was threatening. It was estimated 13-15% of bank's total outstanding loans remained due date one or two years (Morduch 1999), ruining the bank's institutional sounds and thus driving the decrease of external funds in relative terms to almost 4 per cent. Grameen bank with high profile of social missions and the trust relationship between the banks and its clients for loan repayment could easily access to concessional funds but when it was trouble, the bank was at risk of meeting operation cost and had to borrow Tk 3,250 million (or 46% of its resources) from the commercial banks at the market rate. Bad situation forced the bank to decide to change its financial strategy.

Table 15 External funds available from different sources, 1985-94 (million taka)

Year	Bangladesh Bank	IFAD	Norway (NORAD)	Netherlands	Sweden (SIDA)	Ford Foundation	Commercial banks	Grants*	Total	Foreign funds as a share of total (%)
1985	206.60	180.10	0.00	0.00	0.00	3.96	43.30	-	-	-
1986	80.80	587.60	0.00	44.30	0.00	3.96	0.10	5.92	886.98	90.88
1987	19.00	556.30	123.40	44.30	156.20	18.08	-	7.33	905.61	97.90
1988	14.80	747.20	187.90	44.30	220.70	18.08	-	180.54	1,413.52	98.95
1989	193.80	957.10	267.90	44.30	238.90	18.08	-	377.22	2,097.30	90.76
1990	183.40	1,085.70	267.90	44.30	238.90	66.37	-	967.12	2,853.69	93.57
1991	173.00	1,085.70	267.90	44.30	238.90	66.37	-	1,351.46	3,227.63	94.64
1992	-	1,257.70	267.90	44.30	238.90	66.37	3.10	2,445.86	4,324.13	99.93
1993	3,500.00	1,352.60	267.90	44.30	238.85	66.37	-	2,886.27	8,356.29	58.12
1994	3,500.00	-	-	-	-	-	3250.00	261.49	7011.49	3.73

Note: ***Grants include revenue grants and grants for on-lending.**

Source-. **Grameen Bank, world bank report on GB performance and sustainability.**

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Transforming into free-subsidized bank

In 1995 after the implementation of the Grameen Generalised Systerm (Grameen Bank II), Grameen bank's leaders decided to stop requesting donor money in order to avoid any interfere on business operation from foreign actors and move toward to be self-finance. The years 1998 marked the last year when the bank received external aids (Yunus 2006: Banking with the Poor without collateral). Since then, the bank has relied almost entirely on borrower deposits and local loans. For that target, two main financial policies have been deployed:

+ Increasing number of savings deposits from members and started accepting deposits from non-members in 2003 to finance its bank's operations.

+ Increasing fixed deposit investments in commercial banks in Bangladesh rather than disbursing more capital as loans.

These financial strategies have been considered to be smart and made use of the most advantages of the "special status" of Grameen in comparison with other local microfinance providers who have the right to mobilize capital only from their members. They not only assist the bank in changing its funding profile but also contribute to achieve many objectives of the bank such as avoiding currency exposure risks and market saturation, expansion in slow speed, maintaining liquidity,

Chart 15 : Deposit/ Borrowings from banks
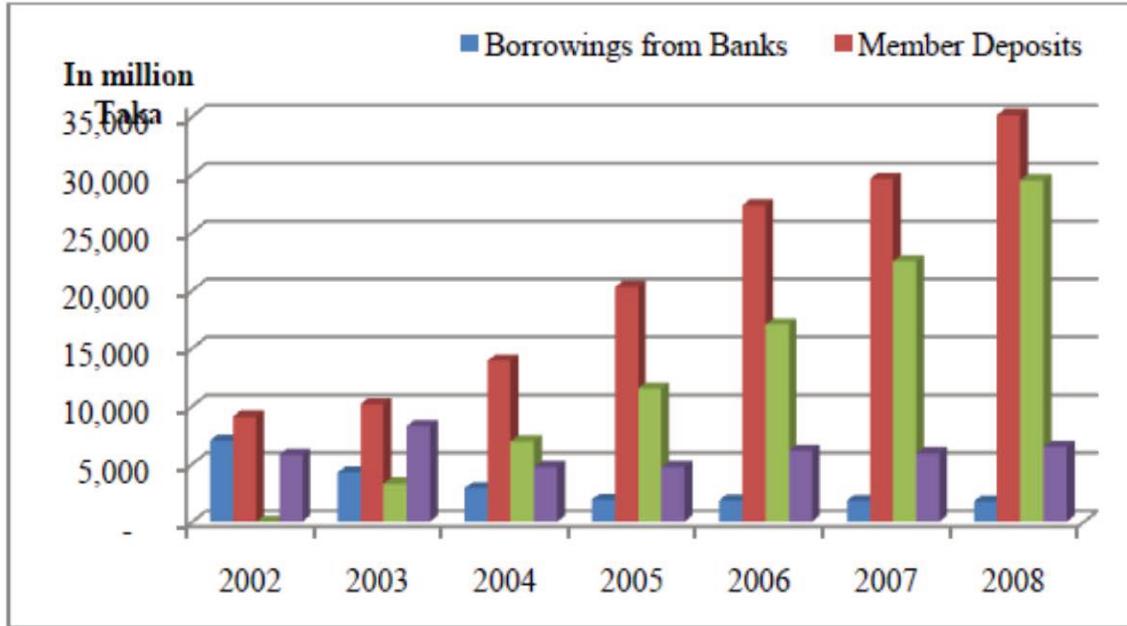
Source: Grameen Bank Audited Financial Statements

However, there are still many doubts on Grameen bank's long term financial sustainability. Annually, Grameen bank account are monitored and completed by certified public accountants but they do not strictly conform to international accounting standard in terms of measuring profit, loan repayment rate and loan loss provision. Besides measuring profit by including the income from direct grants, the bank always moves categories and expenses around to ensure a modest profit to be posted. "Some disbursements are treated as expenses before profit is calculated while other are treated as allocations after profit is calculated"[34]. Loan loss provision are made only to the extent that the bank can still report positive profit.

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[34] Morduch 1999: The role of subsidies: evidence from Grameen Bank.

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4.3.2   Case of Bank Rakyat, Indonesia (BRI bank)

Indonesia has the largest economy in Southeast Asia and a classification of new emerging industrialized country in the world. Being a member of G-20 major economies, Indonesia plays as a driving force within the Association of Southeast Asian Nations. It is also one of the first countries to develop commercial microfinance in Asia with regulated financial institutions providing a bulk of microfinance services. Standing out of the Asian Financial Crisis of the late 1990s, Indonesia economy started to come back on track in the mid of 2000s and continues to prove resilient to the Global Financial Crisis 2008-2009. The country keeps maintaining impressive macroeconomic indicators: 5-year compound annual growth of 5.8%, un employment at 6.2%; both public and private debt felt down sharply at 25% of GDP while international reserves has grown fast and inflation has been under control. [35] These successes are results from many economic reforms to address structural weaknesses, improve regulatory efficiency and modernize financial sector. The financial system of Indonesia is dominated by banks, accounting for 50% of GDP and 80% of financial system. However, activities are indeed concentrated in a few large commercial banks with estimation of one-third of the banking sector asset and deposit base belongs to top three state-owned commercial banks in which Bank Rakyat Indonesia (BRI) took an early lead in Indonesian large-scale commercial micro-banking and has been the dominant player for more than two decades. This oldest bank in Indonesia was stated-owned company until 2003 when it listed 30% of the shares on Indonesia Stock Exchanged (IDX). From a government-owned agricultural development bank, Bri made good use of government seed money and a world bank loan during an initial phase and can be transformed to be the country's second largest lender by asset and the largest sustainable microfinance network in the world. Its business focus on providing carefully crafted micro-

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[35] Indonesia data 2014-Economic outlook

savings and microcredit products to low-income people at market rates of interest. It also has a comparatively small but growing, corporate business. With an outreach of 50 million saving accounts and 25 million borrowers through a network of more than 10000 outlet operating real time online covering both urban and rural areas, the bank can cover its costs from interest rate margin and finances its expansion from it profit[36]. Especially, the bank's micro-credit products like a non-target loans from $5-$5000 at rural market interest and unrestricted deposit services are very attractive and meet demand of retailed-poor clients. The bank can create an easy access for their poor clients to their financial services without any credit bias and at the same time mobilize their saving cost-effectively, making an increased volume of loanable fund by exceeded-wide margin between demand for deposit service and demand for credit. Their smart incentive financial policies, and motivated staffs together with continuously effective innovations in internal management and supervisions helped the Bri Micro-Banking Division weather the Asian financial crisis well and become a unique profitable bank every year since 1986 even during the crisis years of the late 1990s when the country's financial systerm collapsed.

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[36] Official website of bank PT Rakyat, Indonesia.
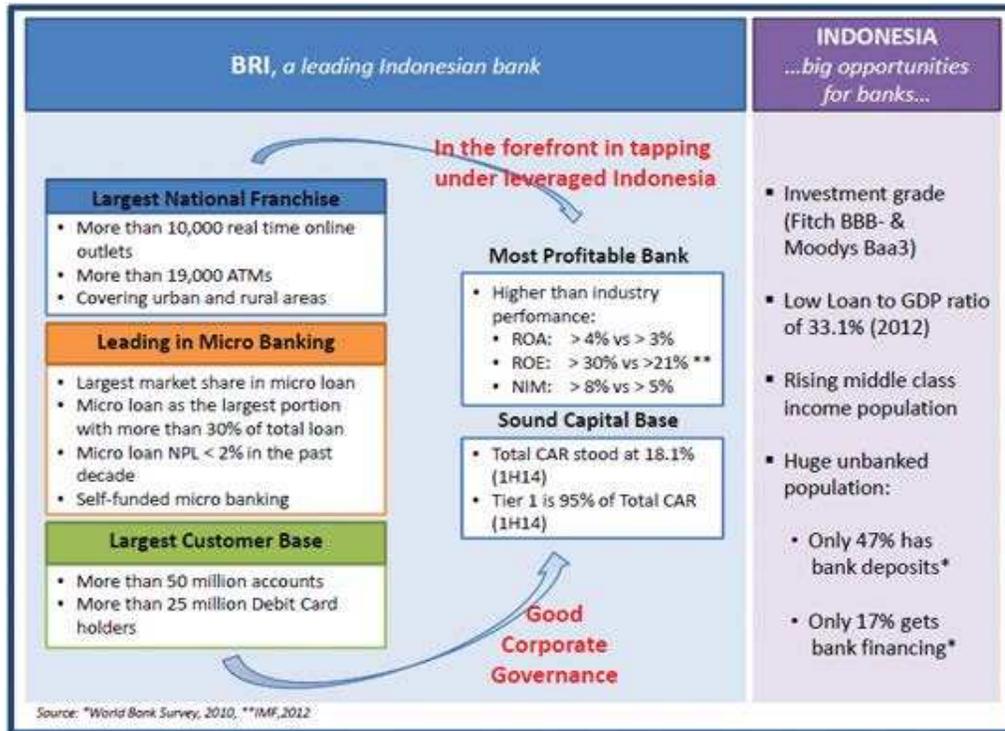
Source: official website of bank Rakyat, Indonesia http://ir-bri.com
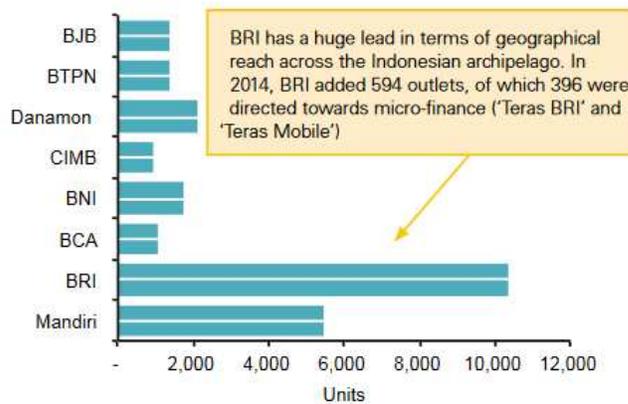
Chart 16 :
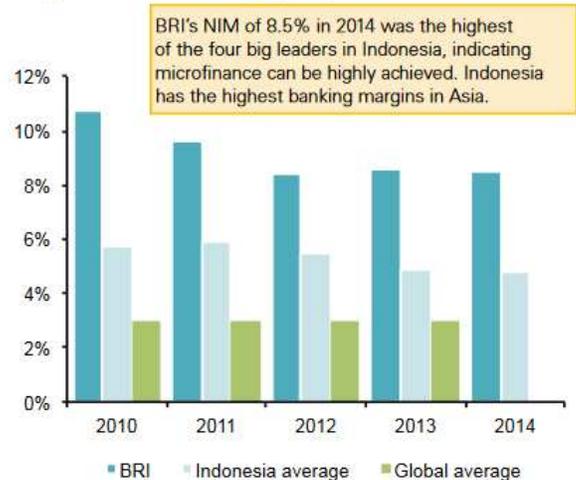
Source: New Indonesian "branchless banking and Microfinance Laws-a catalyst for microfinance growth? - KPMG Indonesia.

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The triumph of Bank Rakyat Indonesia in helping the poor and providing microfinance services sustainably and profitably is not only the pride of Indonesia microfinance but it also has far-reaching implications for the future of commercial microfinance globally and for social and economic development generally.[37] The evolution journey of BRI could be divided in to two phases: from 1895 to 1983 and from 1984 until now. The first phase was marked with the success reform of the BRI micro banking units-unit desa (village units) and the second phase was linked with the restructuring of BRI as a whole. Factors contributing to the success of BRI lay on its continually innovation and keeping adaptable with environment changing from both inside and outside the institutions.

Factors driving changing momentums for Bank Rakyat, Indonesia

External factors gave impetus for the bank reforms at initial stages. Historical changes in Indonesia in controlled-government, legislation as well as political economic in macro level had great impacts into Bank Rakyat. Under the Governments' policies, the bank restructured continually, kept changing its operation directions to adapt to Governments' requirements. In the context of stable political economic context, correct financial policies from Government contributed to shape a new form for BRI, gave them a new direction, marking a great turning-point in the bank development way.

Going back in time to the origins of bank Rakyat Indonesia (Bank BRI) to know about the change of the bank from subsidized government bank to one of the biggest financial self-sufficient microfinance institution in the world. The starting point of Bank BRI foundation began with some details that were similar to the origin of Grameen Bank in Bangladesh. BRI's ancestor, the Briyayi Bank of Purwokerto was created in 1895 by Raden Wiriamaadya, a

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[37] Marguerite S. Robinson-Why the bank Rakyat Indonesia has the world's largest sustainable micro-banking system 1 December 2005

Javanese government official who always created financial opportunities for the poor and put his trust into their capability of loan paying back. In 1894, Raden Wiriamaadya gave a low-interest loan in his own money to a teacher to help him pay back usurious loan that the teacher had borrowed from money lender to finance a family ceremony. Not only that, Raden Wiriammadya also used to extend loan from the local mosque's treasury to civil servants and others. In December 1895, with the approval of his Dutch colonial superiors, he founded the Hulp en Spaarbank der Inlandsche Bestuurs Ambtenaren, for the civil service gentry, or *priyayi,* in Indonesia. In 1897, under a new manager, de Wolff van Westerrode, the bank experienced its first reorganization and renamed Poerwokertoesche Hulp, Spaar en Landbouw Credietbank, popularly known as Volksbank (the people's bank). Intended for the Indonesian elite in its first years, the Dutch administration organized it as member owned institution with outreach to creditworthy Indonesians of any occupation, as well as European civil servants in the regency in Indonesia. Its products were expanded to include savings and credit in kind as well as cash. The bank had protection provided by the government or state. It became the model for two types of institutions: banks for the priyayi, and cooperative banking institutions following example of European banks at that time with a more diversified clientele. Although having a long history since 1980s, the present form of the bank only emerged after Indonesia's officially acknowledged independence in 1950 when the bank renamed as bank Rakyat, Indonesia (BRI) and was declared a government-owned bank conducting banking business in general including saving, credit and other services; guide and supervise cooperatives and villages banks; handle government programs and acts as a special bank for groups that were beyond the jurisdiction of other financial institutions.

During the 1960s, BRI underwent several structural changes to promote the government's social agenda. The bank was even merged with another state-owned bank to support cooperatives of farmers and fisherman with subsidizing lending and then separated to be reestablished as commercial bank which provide finance for small enterprises and microenterprises as well as agricultural production through Bimbingan Masal (Bimas) (mass guidance) program of subsidized credits to farmers' groups. To manage the Bimas program, BRI established a network of unit desa in rice-growing areas, mostly one per sub-district. The number of BRI unit desa supported by a government subsidy grew rapidly from 18 in 1969 to 3600 in 1983. Although having authorization to mobilize savings, this source of fund remained insignificant. The financing source of these unit desa still depended mainly on government funds. After few years of operation, the portfolio quality of these subsidized lending programs deteriorated rapidly. Bimas programs failed terribly with one third of their clients were in arrears. The default rates of Bimas borrowers surged to above 50% as of 1982, resulting a heavy loss. Failure of Bimas programs was consequences of many mistakes in banking management and operations: Government 's fixed loan term and ceilings, subsided saving and borrowing interest rate, illegal extra charges by loan officials, onerous procedures, frequent delays beyond the time of planting and restrictions of allowance loan purposes to production-oriented agricultural target paralleled with poor skilled staff. All these faults poisoned the purpose of Government's effort to improve farm productivity and increase food self-sufficiency. Besides, financial market had some troubles: oil price declined sharply in 1982 reduced Indonesia's oil-related revenue and forced government to withdraw from the expensive subsidized lending program. The loss of oil export initiated an era of deregulation and a shift from supply-driven to a demand-oriented approach. Government was no longer replaced by increasing market forces to be prime mover of development. Policy measures in 1983 comprised full interest rate deregulation, the elimination

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of credit ceiling and a reduction of central bank liquidity credit. When BIMAS was phased out at the end of 1983, future of unit desa network were put at risk; BRI was given two options: either introduce drastic measures to increase the profitability of the units or close them down. With the encouragement of Indonesia Ministry of Finance, BRI opted the latter, converting unit desas into rural banking network, opening a new chapter for the development of the bank in term of both its form and is practice operation methods as well. This marked the beginning of a process which eventually made BRI one of the largest and perhaps the most successful provider of commercial microfinance in the developing world[38]

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[38]Hans Dieter Seibel with Agus Rachmadi- Growth and Resilience of Savings-based Commercial Microfinance Institutions:The Case of the Microbanking Units of Bank Rakyat Indonesia

External factors have created motivations for the initial reform of the bank:

- The oil price collapse in 1983 and the decline in oil revenues forced the government to impose austerity on budgetary expenses and subsidies.

- Economic pressures made politicians adopt a commercial approach to rural microfinance

- During the scaling-up period, stable macro-economic conditions (*economic boom with an average of 5.0% growth in real GDP per capital over 1980-1997*) and a series of financial sector reforms provided a conducive environment in which the new Unit system could develop and prosper. The government's long-serving economics team provided continuing high-quality leadership, characterized by a finely-hone combination of vision and caution. In order to accelerate commercial transformation in BRI network, some Government decisions affects the turnaround included:

- Government supported fund for BRI units just in two early years but no longer.

- BRI was informed that the units would either succeed commercially by then or be closed

- Only commercial credit to be available at the units. Although government decided not to stop the credit subsidies at BRI but limited them at branches at district level in order to take subsidies out of the units and let market forces operated there.

- BRI units were able to operate autonomously and stayed free from government intervention such as credit targeting, interest rate restrictions or any interference in lending decisions.

Internal factors such as the bank's local innovations in organization, business operation, human management and financial performance affected the bank's long-term sustainability and transferred the micro-banking unit from subsidy into self-reliance.

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Innovation in Institution organizations

The organizational structure of Bank BRI comprised of four tiers in which the units represent the bottom layer:

+ The Head Office in Jakarta

+ Regional offices supervise and do internal auditions for branches and units

+ Branches at district level responsible for their own retail business and program lending as well as guild and supervision on the Unit desa located on their area of operation.

+ Desa Units or called BRI units at sub-district level as well as village service posts.

Although both branches and units are part of the same organization, the Unit Desa System can be clearly distinguished from the branch network in terms of target groups, services and mode of operation. Microfinance services are provided through BRI units. Restructuring BRI units was undertaken through a careful and strategic decision-making process from choosing unit business location to organizational structure and management. The BRI units were defined as the nucleus of the entire system, instead of being located in rice-grown areas as before is now common found in central location of the sub-district town near the market place. They were set up as a highly decentralized and semi-autonomous financial entity to ensure flexibility and quick respond to customers' requirements. There were only a small, limited structure team in each unit including four staffs- a manager, a loan officer, a teller and a desk official. Everyone were well trained and retrained by regional BRI education and training center with marketing, accounting knowledge; clear mission and division of responsibilities in minds and professional working skills. A teller at a unit could handle various transactions such as money transfers, check clearing, bill payment and other noncash transactions in one stop. Staffs were also provided incentives which served to motivated them to make their units attain the outreach,

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transparency, and profitably that were expected, however there were also penalties especially for unit managers of poorly performing units like losing their lending authorities and promotion chances (*happens when loan arrears exceeded 3% for a certain period*). Each unit covered about 16-18 villages at sub-district and serves an average of 10000 savers and around 1000 borrowers. If the business of a unit expands and staffs' works could be over-loaded, the Unit is split to keep the operation small and focus. BRI units were placed under their own administrative structure, supervised by branches and audited by regional offices. They could adopt market-based interest rates on loans and transformed into full service rural banking outlets. The accounting system allows each unit's performance to be evaluated as profit center, they have their own balance sheet, profit and loss account. A standardized management information system MIS centered on a few key performance indicators provided timely information to managers and supervisors at all levels.

At the head office, there is a separate division managing performance of Unit Desa Business (BUD) and consolidating business reports from the regions into a national-level management information system that provides the basis for policy decisions. During the first decade of transformation, the Unit Desa operations were directly supervised by the President Director himself. Today, it is under the responsibility of the Managing Director and an international consulting team from the Harvard Institute for International Development (HIID) sponsored by the World Bank and USAID to provide Policy and technical advices.

Innovations in institutional financial strategy and business performance.

Changing of the Bank Rakyat Indonesia was undertaken comprehensively and completely: redesigning organizational structure combined with innovation in financial strategy and business performance. Like many other microfinance institutions in the world, at the start-up period, BRI

unit desa received funds for reform from two major sources: an injection of Rp210 billions of seed capital in 1984 from the government for loans and initial administrative costs; and a World Bank loan of USD102 million, distributed as follows: USD5 million in 1987 for technical assistance and USD97 million in 1989 for liquidity support. However, financial aids from local and international donors couldn't make the bank to be passive in their business operations. Their financial sector policies work and conductive to financial innovations.

At the customer or market segment level, the units moved away the previous commodity approach and adopted so-called income-approach instead. Potential unit customers were not only focus on farmers, crop agriculture and seasonal loans as before but anyone who was able to save and repay a loan. The bank provided credit to any creditworthy person for any income-generating activity such as petty trading, agriculture and agriculture input trade, industry, services, horticulture, operation of small plantations and livestock-related activity as well as customer credit.

At the product level, innovations in savings and loan products were emphasized through the attractive design of two new savings and loan products at the units. One called Simpanan Pedesaan (Simpedes) was a saving products for those living or doing business in rural areas. This product provided for unlimited withdrawals at any time and had a lottery component with prizes and awarded at well-publicized public events. Simpedes has become BRI's most attractive saving product, outperforming time deposits and other savings products by wide margin. There are no fees to open an account and except for the smallest balances (less than USD10), it has a positive real interest rate and therefore favoured by low-income households. The other innovation was a general rural credit product. Kredit Umum Pedesaan (Kupedes) which provided for monthly installment payments and was open to all borrowers for any

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purpose. Kupedes enabled the units to diversify their portfolio away from mainly agricultural loans and toward various business and consumer loans, rural as well as urban. Portfolio diversification is thus ingrained in a single product. Doing microfinance operation for commercial target, so BRI units still require collateral from borrowers however, it is flexible in all kind of forms that suitable with clients and especially non-collateral for small loan up to USD500. Sufficient collateral is required from borrowers to cover the loan value in the form of land titles or by the pledging of buildings, motorcycles or other properties. Initially, the loans were given amounting to between $3 and $1,000 but over time the maximum loan size increased, now it could reach USD10000. BRI also introduced an incentive system for timely repayment of the loans with two components: a refund of 25% of the amount of interest due and the expectation of repeat loans of increasing size if all installments were paid on time.). However, a penalty of 0.5% per month is imposed on the borrowed amount for late payments. For customers who did not have enough to fulfill the required collateral so as to qualify, they may surrender properties such as their radios and TV sets just so to instill some psychological impact on them as borrowers although admittedly BRI actually could not sell any of such collaterals. This turned out to be a powerful instrument for arrears prevention, as approximately 95% of the borrowers repaid their loans on time, a proportion which increased to 98.8% in 2007.

Unlike Grameen Bank of Bangladesh, funding of Kupedes was not dependent on funds from abroad but was funded by locally mobilized savings. In order to ensure that BRI units break even within 3 years, the KUPEDES interest rates was set at 1.5% flat per month on the original loan balance (equivalent to 33% annual effective rate. Under the reform measures, high priority was given to mobilizing savings which became an integral part of the village unit philosophy. The successful SIMPEDES rural saving products were designed and conducted based on results of many research and extensive market surveys on the demand for savings and loan products

involving low-income people. These studies provided evidence that people in rural areas tend to be savers rather than borrowers and they would like to have freedom to withdraw their money whenever they want. Hence, unlimited withdrawal savings products were seen as an effective instrument of resource mobilization. Following the success of SIMPEDES, its urban counterpart called SIMASKOT with an emphasis on security was introduced in 1989. As a savings product for the urban community, SIMASKOT has the same basic features of SIMPEDES except for the interest rate structure. Interest rates for SIMASKOT is generally higher than that of SIMPEDES because the former takes into account the larger savings capacity of urban customers and the stiffer competition that BRI faces with other banks operating in the urban areas. Hence, interest rates ranged between 11% and 14.5%. TABANAS BRI is also another government saving program offers similar features as SIMPEDES but is not as popular because it allowed no more than two times a month but lotters combined with prizes in cashes which is the most attractive ways to rural customers in Indonesia. TABANAS aimed at school children and students. Safe deposits with positive real returns throughout the years and easy access to repeat loans for any purpose at market rates of interest combined with powerful incentives to clients and staff had help the units turn profit in 1986 and in 1988, they accounted for 30% of BRI's total net income. During 1989, the units broke even in terms of savings mobilization and loans outstanding and began generating surplus liquidity and by December they generated excess liquidity of USD63 million. Since that time, BRI units have been completely financially self-reliant in mobilizing their own resources, covering their costs, and earning a profit. In term of volume, the deposit-to-loan ratio has been about 2:1, thus only half of the fund mobilized by the Units were recycled as KUPEDES loan and the other half were transferred to the branch system. For the units, the fund transfer was attractive because they were paid an interest rate- the so-called transfer price-which was normally set slightly above the interest rate paid on time deposits. The branches easily

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absorbed the units'excess liquidity and channeled the fund into large corporate loans that were rapidly expanded during the 1990s. The total sum mobilized and transferred to the branches from 1898 to 2008 amount to USD 23.7 billion (Seibel 2005, 2007).

Chart 17 : Deposits and loans outstanding of BRI microbanking units 1984-2008 (in million USD)
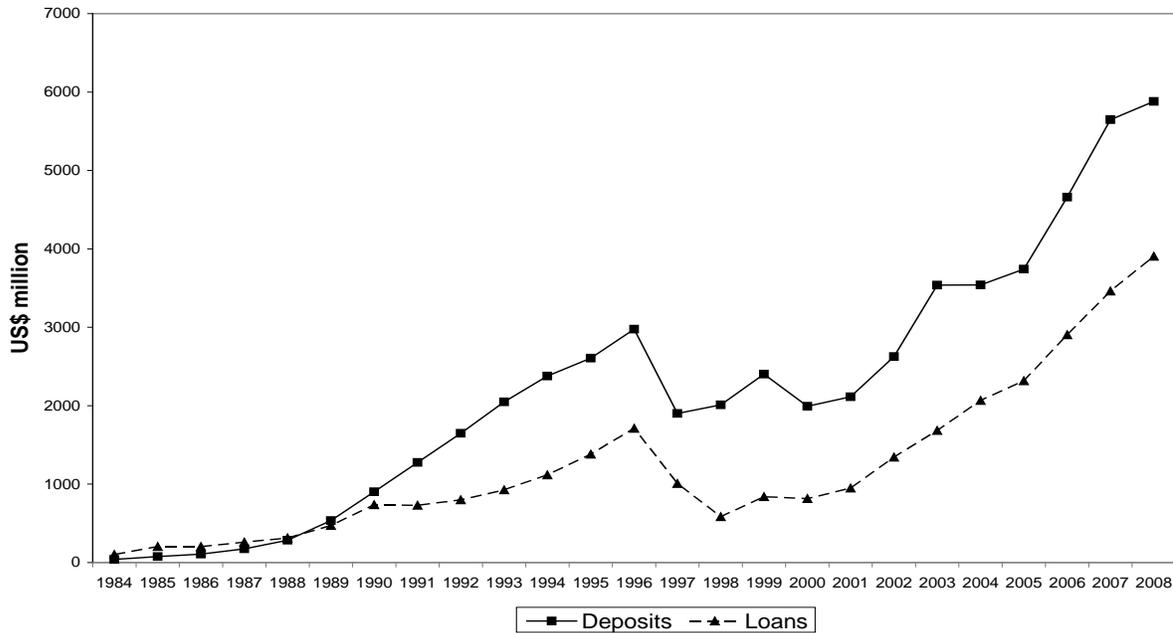
Source: Seibel 2007- Growth and resilience of Saving-based Commercial Microfinance Institutions:-

the case of the Microbanking Units of Bank Rakyat Indonesia

Strategy of BRI units to maximize their outreach and yet remain profitable is including among customers both the poor and the non-poor and cater for their respective demands for smaller and larger loan sizes, whereby the latter cross subsidize the former. Excluding the non-poor from their clientele would substantially their outreach to the poor. Only small local financial institutions, such as cooperatives and other village-based institutions, can handle very small loans cost-effectively. In order to reach all segments of the rural population with financial

services, the bank takes a differentiated rural financial infrastructure in which various types and sizes of financial institutions compete with each other.

Besides retail microfinance business, in order to increase profitability, Bank BRI took effort to strengthen its wholesale segment. BRI participates in a treasury single account of government budget and acquires minimum 70 percent of money flow from the government budget. The bank has established an institutional business division dedicated to capturing the business opportunity with institutions and organizations. Low cost fund and fee-based income are the ultimate goals in this segment; services include salary crediting and cash management.

Aligned with the institutional business expansion strategy, BRI has changed its strategy in the corporate loan segment by focusing on financing state owned enterprises /government projects and corporate business that have a link with micro and small businesses. The main objectives of financing SOE/government project is to save capital due to lower risk weight of SOE exposure ranging from 0 percent to 50 percent. More importantly, financing corporate businesses that link with small businesses will create trickle down effects to BRI's microfinance segment.

Diversifying loan products with other banking services helped almost doubled loan portfolio of BRI during the four-year period from 2005 to 2008: from USD7.7 billion to USD14.7 billion. As of 2008 almost half the portfolio has been in microloans up to USD5,000 (27%) and salary-based consumer loans up to USD20,000 (19%). These two business segments with relatively small loans have by far the best performance, with NPL ratios of 1.0% and 1.1%, respectively. Small commercial loans up to $500,000 account for 28% of the portfolio, at a considerably higher NPL ratio of 3.5%. Medium-scale loans up to $5 million account for 7.7% of the portfolio, at a yet higher NPL ratio of 6.3%. Corporate loans, kept below 20% of the portfolio as per decision of the Government as the bank's majority owner have an NPL ratio of 4.5%.

The two small-scale business segments, micro and consumer lending, despite an already excellent performance in 2005, succeeded in bringing down their NPL ratios by about one-third, notably unimpeded by the global crisis 2007-2008. Small and medium commercial loans improved their performance slightly, the latter however with a higher ratio in 2008 compared with 2007. The most impressive result has been achieved in corporate lending, much of it agricultural, with innovative approaches in supply chain finance and in agribusiness public-private partnerships, its NPL ratio cut down to about a quarter of its 2005 level. Other financial indicators also showed quite good results ROA, felt slightly, from 5.4% in 2005 to 4.6% in 2007 and 4.2% in 2008, while ROE fell from 37.9% in 2005 to 31.6% in 2007, then rose to 34.5% in 2008. There is almost no visible effect of the global crisis on the performance of BRI's portfolio as a whole.

Table 16 : BRI portfolio composition and NPL ratios, 2005-2008

Business segment	Loan size in US$ (2007)	Non-performing loan ratio				Portfolio 2008 in %
		2005	2006	2007	2008	
Microbanking	Up to 5,000*	1.55	1.36	1.19	1.02	26.6
Small consumer	Up to 20,000	1.62	1.91	1.67	1.08	19.0
Small commercial	Up to 500,000	4.06	6.32	5.71	3.52	27.6
Medium	>0.5-5 million	7.48	5.87	5.67	6.33	7.7
Corporate	>5 million	16.93	13.55	4.62	4.53	19.1
Total		4.68	4.81	3.44	2.80	100.0
Total in billion US$		*7.68*	*9.61*	*12.09*	*14.71*	

*Raised to US$10,000 toward the end of 2008.

Source: BRI 2009

In the process of expansion and scale-up their business in order to raise equity capital, Bank Rakyat, Indonesia was among first few microfinance institutions in the world started accessing resources through public issue in the capital market. BRI became a partially privatized public company in November 2003 after the sale of 41 percent of BRI shares to the public through an initial public offering (IPO). The bank is listed on national stock exchanges and had sold internationally. The IPOs and listings have allowed bank BRI to tap into the mainstream investor community and take advantage of myriad new opportunities. The successful IPO drew strong interest from investors—its shares were over-subscribed by 16 times and was the largest equity deal since the financial crisis. Total proceeds from the IPO amounted to Rp 4.1 trillion (US $486 million), of which around Rp 2.5 trillion (US $297 million) is to be transferred to the state budget and the remaining is to increase BRI's capital. According to the paper *Asia Money,* BRI become "the best newly list company in 2003". By December 2004, the share price had reached nearly three times the strike price. Since the start o5.3 f the crisis, Indonesia has had difficulty attracting foreign investors (to a significant extent because of continuing problems in its legal and judicial systems). But BRI is a striking exception. After its initial public offering, government owned 59.5% and 40.5 belonged to the public in which 55.3 went to foreign investors and 44.7% to domestic investor. However, by 31 December 2003, most of domestic owners sold their shares making a change in the public ownership with composition to 20.9% domestic and 79.1% foreign. Going public has required a paradigm shift for BRI; it has been crucial for the bank to comply with capital market regulation and gain the trust of shareholders. This has also signaled to capital market that the microfinance sector is a potential source of profitable investment

4.3.3   Case of Vietnam

Vietnamese microfinance characteristics.

In comparison with Indonesia and Bangladesh, microfinance sector in Vietnam appeared later thank to the influence of global micro-finance development. It emerged during a period of national robust economic growth since 2000 and has grown rapidly. Demand for financial services has increased with rising incomes and dropping poverty levels. Vietnam lowered its poverty headcount from 58% of the population in 1993 to 37% in 1998; 29% in 2002; and as low as 24% by 2004, meaning that a third of the population has been lifted out of poverty during this period. The DFC Group report to the WB, *Developing a Comprehensive Strategy to Expand Access to Microfinance Services* (Volume I, The Microfinance Landscape in Viet Nam – February 2007), documented a rapid growth in Viet Nam's financial sector and with it the coverage of low income and poor people ("outreach") by microfinance institutions. It estimates that between 70-80% of the poor are able to access some form of financial service, mostly in the form of short-term credit and savings, and that the formal banking system appears to reach a substantial number of them. However, poverty was different between rural and urban areas, economic regions, ethnic groups, education and gender. Poverty was reduced in a much slower pace in the central region, the poorest in the country and northern mountain and north central coast while the proportion of ethnic minorities in the overall poor population increased representing an existing huge demand of microfinance in rural areas especially in remoted mountainous areas. Vietnamese current microfinance system although extensive in most recent years has been still shallow penetration. Government uses a dual approach that is both market-based and state-driven to ease the financing constraints of poor and rural households. Target policy lending with subsidized interest rates remains substantial in the country's microfinance

sector through operation of government poverty-reduction funds under the Vietnam Bank for Social Policy.

Of the three -primary formal sector financial service providers (Viet Nam Bank for Agriculture and Rural Development [VBARD], Viet Nam Bank for Social Policy [VBSP], and People's Credit Fund [PCF]) serving LIHs, only VBSP targets the poor directly with below-market subsidized credit (albeit on an exclusively supply-driven basis, driven by socio-political 'coverage' targets). Activities include lending to the poor, job creation activities, student loans and lending to flood-resistant housing. VBSP's services are currently necessary for social policy purposes but it also raises many doubts on the sustainability of the system and the issue of social policies versus financial principle. As a State owned Commercial Bank (SOCB), VBARD on the other hand has the strongest systems for commercial banking, but has not integrated microfinance into its product range as a specialized and potentially profitable service to poorer customers in its own right. VBARD appears not to be convinced yet that the poor might be a profitable market segment, perhaps because it cannot compete head-on with the subsidized VBSP. Nevertheless, VBARD estimates 47% (end 2003) of its rural borrowers or some 2.8 million households to be poor, making VBARD the largest provider of the full range of microfinance services (savings, credit, money transfers etc.) in rural Viet Nam[39]. Finally, PCFs are possibly the most demand-oriented of the formal sector financial service providers in Vietnam at present by way of their savings-led and member-owned nature, however their market share and growth potential are constrained by licensing criteria related to area of operation (geography and coverage). The dominance of the state-owned banks and the popularity of targeting lending at subsidized interest rates have effectively kept levels of micro- lending from non-government organization (NGO)-type microfinance institutions and privates-sector entities insignificant. Of the social

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[39] World Bank: TOR for DFC study to develop a comprehensive strategy for access to microfinance service in Viet Nam, 2006.

organizations and government programs involved in micro-finance activities, the far-reaching Vietnam Women's Unions (VWU) and the Vietnam Farmers Unions have by far the most experience. One of the most characteristics of these non-state MFIs is almost always heavily involved with mass organizations (for example Vietnam Women's Unions which are intertwined with the government and are also subject to interventions by local government officials) showing a direct involvement of Government in the provision of microfinance services in Vietnam. The business performance of these Non-state microfinances institutions has been relative small and limited in comparison with state-owned organization in term of client bases, lending amounts, loan sizes. Except TAO YEU MAY Fund (TYM) and the Capital Aid FUND which have loan portfolio of USD15 million or USD20million with 40000 and 80000 clients respectively, the other non-stated microfinance institutions have just from few thousand to 10,000 clients with loan portfolio of less than USD1million. They operated in rural areas, providing small loans which ranged from USD150 to USD300 for almost women. These institutions don't generally borrow from commercial sources for their capital, have been dependent mainly on international aids or donors. They are not under the supervision of Vietnam State Bank

Box 4 : Viet Nam Unique non-state Microfinance Institutions

The typical microfinance institution (MFI) in Viet Nam is different in many ways from those in Asia or the rest of the world. Eight of the most salient characteristics that set Vietnamese MFIs apart are that they:

1. have **fewer clients**—half the average worldwide and onethird of that in Asia, even across peer groups;

2. have **smaller loan portfolios—**a tenth of international (world or Asian) standards;

3. have **lower (recorded) expenses** in terms of their expenses/assets ratio, which mostly reflects their lower operational expenses, although their financing costs are also lower. That they have lower expenses is the result of their receiving a number of implicit subsidies from the Vietnam Women's Union (VWU), ranging from free rent to heavy subsidies of credit officers' salaries. As these are some of largest costs of MFIs internationally, it is not surprising that Vietnamese MFIs are better able to cover their (reported) expenses than international MFIs (as measured by operational self-sufficiency);

4. are **more poor-focused** by having smaller loan sizes (relative to national per capital incomes) than their international peers;

5. lend almost entirely to **women,** unlike many MFIs outside Asia;

6. generally **do not borrow,** as their foreign counterparts do, because they are funded almost entirely by equity and savings. This may reflect the absence of microfinance regulations until very recently;

7. charge **lower interest rates**, as measured by their nominal yield. As a result, their revenue/assets ratio is from a half to a third of those of their international peers. This may be the result either of the competition from the subsidized lending of the Vietnam Bank for Social Policies or the lower (reported) expenses, allowing them to charge lower interest rates while still covering costs; and

8. have **more productive credit officers,** who have higher average numbers of clients served. This might be partly explained by the fact that client monitoring is often done by VWU staff.

Source: Vietnam Microfinance Working Group. 2008. Viet Nam Microfinance Bulletin

Microfinance Operation Assessment.

Although banks in formal financial sectors and MFIs in semi-formal sectors to some extent can meet the needs to borrower by offering variety of options, the needs from the poor, especially the rural and remote areas for rural services are variable. The poorest needs special schemes and special programs to survive while better-off clients need flexible schemes which allow them to borrow at any time to expand their family business for poverty escape. Following tables describe the need of the rural poor by credit purpose category and loan structure by banks

Table 17 : Needs and expectations by each category

	VERY POOR	MIDDLE POOR	BETTER OFF	RICH
Demand side				
	To survive for shocks (health, disaster)	To buy seeds, fertilizer To grow garden or	To open business (services, small and medium	To expand the farms (large scale fishing ponds etc.)

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		husbandry	sized husbandry raising)	Needs for
	To buy seeds and agricultural inputs	Needs for 7 ml to 8 mil VND		above 35 mil to 200 mil
	To raise small husbandry Needs from 500.000 VND to 2 mil VND		Needs for above 10 mil VND	VND)
Supply side				
Services /Institutions	Some funds (Women Union, TYM, CEF, M7 as MFIs and NGO) Programme 135 for poverty reduction VBSP and VBARD normally do not approve the high credits for poor due to high risks	VBSP, Funds or Target programme can't meet the demand due to the limit in credit line to 1-5 mil VND/borrower Programme 135 for poverty reduction	VBARD; PCF/CCF Others: Programme 120 for vocational and jobs	VBARD Commercial banks available
Procedures	Avoid complicate certification at commune authority	Need the poor list and approval from the commune authority and bank documentation	Complicated Costly with frees	
Scheme	Group guarantee scheme Saving together with borrowing Membership	Individual lending Based on need Fixed scheme	Individual lending Based on need Fixed scheme	Flexible scheme
Offers	Interest and principle divided equally- easy for the poor to repay Still big difference to credits and saving interest (free to set based on the market)	Term up to 3 years, interest paid every quarter, principle pad two times during the loan periods No mortgage/collaterals	With collaterals Documentation processing free Higher (market interest rate) Saving is separate	With collaterals Documentation processing free Higher (market interest rate) Saving is

				separate
	Group activities: trainings included	Difficult for the poor to accumulate big amount for repay		

Source: Vietnam report on microfinance-ADB 2013

Table 18 : Loan structure by banks

	VBSP	VBARD	PCF	MFI/Funds/NGOs
Target groups	Better off and Middle	Poor, not very poor	Middle	Poor and very poor
Loan amount	1.3 mil VND	1.8mil VND	Above 300.000VND	From 200.000VND
Terms	3 years	3-5 years	1-3 years	Up to 2 years
Purpose of borrowing	HH business	Business	Multi- purpose	Seasonal Living expenses and micro HH economic activities
Other options	No savings	Saving separate from borrowing	With savings	With small savings mobilization

Source: State bank of Vietnam 2013

It seems that banks like VBARD and VBSP though carrying the social purpose to support the poor and rural development but tends to go to large scale and big credit. Although the operations of NGO MFIs' operations help reach microfinance untouched market segment but can't cover the gap of microfinance formal market. This might imply the exclusion of the poorest who only want the seasonal and small scale to survive over unexpected shocks. In term of microcredit delivery, VBSP still played significant role with a sharp increase of *micro-credit* to poor households and social policy lending target groups thanks to rapid growth of VBSP's portfolio with State-mobilized funds through budget allocations, compulsory deposits from state-owned

commercial banks (SOCBs) and fully Government guaranteed borrowings. As of December 2013, VBSP had lent out to 7 million clients, about more than half of whom are reportedly from poor households. Below is the profile of micro-credit delivery by key institutions in Viet Nam

Table 19 : Microfinance Loan in 2013

Institution	Number of clients (millions)	Loans Outstanding (USD million)	Average Loan Size (USD)	Percentage (%)
VBSP	7.0	5,350	764	46.2%
VBARD	1.5	1,390	927	41.1%
PCFs	1.1	1,294	1,176	12.8%
MFIs/NGOs	0.8	189	236	0.9%

Sources: VBSP Report; VBARD report, Central Credit Fund and Vietnam Microfinance Sector Assessment prepared by ADB technical assistance.

However, VBSP's subsidized policy lending is dependent on public resource, when it has attained remarkable outreach, it is also becoming an increasingly heavy fiscal burden for Government and may not be sustainable in the long term. The bank is subsided for operational expenses and staff remuneration, can change interest so frequently that other MFIs can't adjust and may lose their clients. This in turn would adversely impact on the development of a market-driven microfinance sector, which is crucial in promoting competition and efficiency, as well as in widening the choices of clients for microfinance providers and the services they offer. Besides, the effectiveness of people credit funds is needed to be considered. Under the government control, close of 50% of Central Credit Fund's loan portfolio has been granted to recipients outside of PCF network, with loans to SOEs, small and medium-size enterprises and entities and individuals who are not members. It is not in line with international microfinance standard practices and could be harm to the business performance of People Credit Funds themselves and other MFIs also.

There are basically **two types of loans** presently being accessed by rural poor and low income households:

One-Time Loan: This loan is available in short term (12 months or less), mid-term (> 12 months to 60 months), and long term (> 60 months with no documented maximum) advances. It is referenced as a *"one-time loan"* because the borrower must fully repay the loan before being eligible to request another loan. Loan size and interest rate is established based on the requested repayment terms, the business plan and the collateral value. Usually, interest is paid monthly and principal is repaid at the end of the loan term, however instalment payments can be arranged.

Seasonal Loan: This loan is typically available to farming HH who have two or more crops that overlap during the growing season (i.e. rice, vegetables, aquaculture, etc.) Loan is provided for the first crop and if capital from the first crop proceeds is required to finance inputs for the second crop, rather than repay the loan on the due date, the borrow must submit an application for a second crop loan. It is essentially a form of loan extension.

Other loans that are presently available but not as popular with and/or accessible to rural poor and low- income households are as follows:

Mortgage Loan: This loan is available to better-off borrowers with land/house, savings or bonds that can be hypothecated or mortgaged as collateral. While most rural poor and low- income households in Vietnam have land that can be mortgaged, they are reluctant to do so as it is the only asset they have of any value and they fear losing it if they can't repay the loan.

Credit Limit Loan: This kind of product is available in VBARD than PCF, VBSP or other microfinance institutions. The bank establishes a maximum lending limit and loan

term (i.e. one year) based on the borrower's loan application and makes periodic advances within the limit at the borrower's request. These loans are available for business or consumption purposes.

Consumption Loan: This loan is available for primarily urban consumer consumption purposes (i.e. household appliances, motorbikes, home improvements, life cycle needs etc.).

Credit for Working Abroad: Many Vietnamese work in other countries to support their families at home. This loan is available to cover transportation and living costs for the borrower while abroad.

Loan interest rates are charged and paid monthly and vary based on the approved term and are established within varying ranges at the discretion of the loan providers through negotiation. The previous restrictive interest rate policies as established and regulated by SBV have removed in recent years. There are now no limits on the maximum lending rates that can be charged.

In contrast with the various types of loan option, saving are not common among the poor in Vietnam rural areas. According to microfinance's customer survey reports on from VBARD in 2009, poor customers have high capacity of savings: even those at the lowest level in rural areas may save around VND100 thousand (USD5.00) a month, while most informants who are in the middle level do saving at level from VND100 000 to VND500000 (USD5.00 -25.00) a month, better-off can retain up average to more than 1 million Vietnam Dong (more than USD50.00). But very small percentage of poor people actually do it. If families have surplus money, they want to buy home equipment, build house or invest in their small household business. The people with a need for depositing their savings are often the ones who have a large amount of unusual money (from

winning lottery, compensation for land collection (mat), remittance by family members working overseas...) but they are not able to run business (possible reasons: aging, health, lacking know-how...). In some rural provinces, clients are more familiar with local saving groups (ROSA models-informal microfinance) which were formed depending on tradition of each locality and by occupation. The form is more common with small business persons than with farmers. It is possible that business persons have relatively stable income every day, hence it is convenient for them to take part in the group saving by day, by week or by month. The main advantage of saving groups is the capacity for mobilizing capital flexibly, quickly and promptly. Those, who are the first from the saving group can contribute a small amount but she/he can receive promptly, from the savings fund, a large amount as much more times as than any possible forms of saving via a bank. Apart from that, it is quick as they are not required to follow any procedures, do not need to go away from home. Moreover, it is flexible as there are varieties of form depending on their need, people can call for the persons who share the need to take part in the group. Another attractive advantage of saving group is often at high rate of interest. However, this form also has a disadvantage of high risk. In the localities with saving groups, there often exists phenomenon of «stealing from the group savings by group members». However, because of its advantages and attractions in combination with the need of people for capital at urgent times, this form of saving group is still vital. A long time ago, saving group is a form developed to help each other or to save a large amount used for big events of a family. Therefore, today there are still a number of semi-official saving groups such as the ones of mass organizations (Association of Veterans, Women's Union) and un-official groups, for instance, group of relatives, friends, peers, colleagues using forms of saving for that purpose in kind of gold

or currency. In some province where saving groups become tradition, farmers often do seasonally: e.g. vegetable season, shrimp season etc. Sometime, taking part in saving group is not only to create opportunity to mobilize capital but also to communicate among players, to share know-how experience, help each other when meeting other difficulties in their life. Also, it is where they are able to share their feelings, emotions with members of family, village...Sometimes, their taking part in saving group is not because of an economic purpose but only because of their wish to help relatives, friends. Therefore, although accepting that deposing saving into banks or other semi-formal microfinance institutions has less risks, the people still want their savings to have advantages of saving group, which are accessible, flexible, quick and at soft interest rate.

In order to raise awareness, develop good habits and get beneficiaries used to saving, together with large branching network that allow poor clients easily to access to this kind of services VBARD and VBSP as well as other semi-formal MFIs offered savings products that are designed especially for poor households. These saving products don't limit the amount that can be saved but focus on the regularity and timeliness of such saving measures to help the poor to develop their asset from small amount to large sums for the use of expanding business and dealing with risks. However, scale of micro saving is still limited in comparison with credit loan. The semi-formal NGO-MFIs also mobilize savings, mainly in form of compulsory deposits that can only be withdrawn upon full repayment of the loan and viewed more as a partial guarantee to the client's micro-loan. Major NGO-MFIs offer limited voluntary savings since they cannot compete in paying market interest rates, an added burden to their relatively higher operating costs. VBARD by far dominates the savings service market with its extensive network and commercial banking orientation. Below is the micro-savings profile of major microfinance players in the country:

Table 20 : Estimated rural savers by major players in Viet Nam microfinance in 2012

Provider	Est. No of depositors
VBARD	5,267,000
VPSC	411,830
VBSP	2,148,000
PCFs	1,500,000
NGO-MFIs	430,000
Total	9,756,830

Source: ADB's report on Vietnam microfinance

Beside traditional banking products: loan and savings, micro-insurance, still largely misunderstood by rural households. The usual coping mechanism of the poor HHs against life changing events - such as relying on savings, borrowings, and/or selling of assets - could push them to further poverty. Existing laws allow small- scale financial institutions like PCFs and MFIs only to be agents of insurance companies, with a few local insurers already offering both life and non-life products appropriate for the low-income market. The most notable is Bao Viet Life that offers a range of low-cost life, livestock and health insurance. Others like AIA specialize in credit life insurance through an agency agreement with banks. Prudential has insurance products for women and children under 18.[40] Some semi-informal MFIs with external partners (e.g., ILO, RIMANSI, Action Aid) have also pilot tested Mutual Aid Funds (MAF) that were proven successful in other countries. RIMANSI's experience with TYM is well-documented and shows that mutual assistance funds can be quickly and viably set up, with good

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[40] DFC Report for the World Bank (2007); Vietnam: Developing a Comprehensive Strategy to Expand Access [for the Poor] to Microfinance Services. Promoting Outreach, Efficiency and Sustainability

market acceptance for the two products: life mutuality and loan mutuality. However, with the prohibition on ownership of insurance schemes by MFIs and PCFs, the only option is to develop MAF and other micro insurance products in agency agreement with existing and more progressive insurers.

Decree 18/2005/ND-CP passed in 2005 provides the legal framework for MAFs to transform into regulated Mutual Assistance Insurance (MAI) organizations. A MAI is a legal entity established to do insurance business through self-support and self-help among members. MAI members are both policy holders and owners of the organization and a right to participate in its management making MAI ideal for low-income groups. However, the minimum capital requirement for setting it up is presently considered prohibitive and no MAI has been set up to date.

Other financial products and services like remittance payment and transferring money are very underdeveloped. Although all banks in Vietnam offer a wide range of financial products, including money transfer. Some remittance companies like Western Union and Money Gram operate as agency relationship with banks the amount of transaction are limited because clients are mostly working people with low incomes, mainly demanding credit loan. VBARD with its extensive branching network seems currently to be the best positioned to offer other micro - financial services besides credit and savings.

Wholesaling of Microfinance Funds

In today Vietnam microfinance landscape, besides CCF's wholesaling functions for the PCF network, VWU has been piloted to establish wholesale fund to provide funding for Social Fund. However, with the intial capital of few dozens of billion dong and limited staff capacity, the piloted wholesale fund model needs more time to be proved and evaluated as effective. In recent years, the Bank for Investment and Development of Vietnam (BIDV) has also taken on this role but only on a project basis, as it often acts as the executing agency for domestically and donor

funded projects. Under the World Bank-funded Rural Finance Project III, it wholesales USD 10 million (from total USD200 million project funds) to qualified credit institutions for on-lending to microfinance clients. *Policy Lending and Government Subsidies[41]*

VBSP received Government support in various forms: (a) budgetary allocation and Government guaranteed loans for funding its portfolio growth; (b) subsidies to cover its negative financial spread and cost of operations; (c) 2% compulsory deposits from SOCBs; and (d) tax exemptions. The success of VBSP in achieving its mandate backed by substantial Government resources and subsidies, and 98% coverage of commune's area also seen to discourage the entry of other institutional players.

Unlike VBSP, other microfinance institutions lack of Government's financial support. They often don't have enough funds to develop stably. Their funds often come from charity grants which are always bound by low interest rate commitments when relending so profit can't cover their costs. Among them, the two first regulated Microfinance Institutions TYM and M7MFI can mobilize funds from international resources, deposits and borrow from other credit institutions. However, it is not easy due to many difficulties such as: the two organizations don't have valuable assets to meet the requirement of security properties for local borrowings; for international, they are still too new players to have enough reputation for overseas loans; mobilizing savings from poor people are rather much limited.

Summary analysis of the strategic environment of microfinance sector:

Advantages:

- Macro-economic and political stability and the adoption of market-driven strategies for development and poverty eradication efforts

- Good outreach capacity:

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[41] ADB's report on Vietnam's microfinance.

- Semi-formal MFIs capable of rapid and viable expansion, others may be merged to a few large and transferring into formal MFIs showing capability to fill the gap of untouched market by formal financial sector.

- An effective People's Committee system for problem debt resolution and potential base for information exchange at commune level

- The gender orientation of mass organizations like Vietnam Women Unions benefit women in accessing micro-financial services.

- Presence of several MFI capacity-building providers, notably the Banking Academy and Banking University regulated by SBV

Disadvantages.

- Government's aggressive "social policy lending" through VBSP's a disincentive to other players, reducing competition and choices; and increasingly a heavy fiscal burden with marginal financial benefits to the target HHs;

- VBSP's disproportionate focus on credit deprive its large client base from needed savings and other banking services, while limiting VBSP's to mobilize resources from its market, perpetuating its dependence on Government;

- CCF dependence on Government funding and support, with the concomitant political influence, undermines CCF-PCFs symbiotic relationship vital to their strengthening; very small regular membership base of PCFs resulting in limited capital and prospects for expansion;

- Current roles of People's Committee and mass organizations in the credit process may politicize micro-credit delivery and pose "moral hazards" over the long term;

- SBV lacks the capacity and capability to supervise and provide oversight to a potentially large number of MF players dispersed up to the commune level.

- Lack of credit information exchange;

4.4   COMPARATIVE ANALYSIS

Microfinance institutions working in a certain country are influenced by not only common economic factors such as country population, income levels and degree of market liberation, but also institutional contexts with factors such as consumer tastes, employee expectations, geographical characteristics, government regulations and local ethical norms. According to the institutional theory literature, institutional environments vary across countries. The concept of institutional distance which was developed in the international business literature stated that cultural, administrative, geographical and economic differences are important factors in shaping the conditions of profitable expansion of business models across national and cultural borders. Under this theory, national institutions play a significant role in establishing, restricting or incentivizing, providing resources and capabilities, defining legitimate and illegitimate behavior for business institutions. Applying this concept as theoretical perspective in microfinance to look at the role of national institutions in shaping diffusion of global microfinance models, we are showed with the diversification of institutional innovation to adapt with the host country context among countries as well as help explain what types of microfinance models are likely work under what type of institutional conditions; why non-profit models maybe more appropriate than commercial microfinance ventures in some contexts. In the cases of Vietnam, Bangladesh and Indonesia, the different specifics of institutional environments among the three microfinance industries resulted in the difference in the choice of microfinance approach, business model, degree of freedom in regulation and financial innovations.

The first different feature is microfinance perspectives among the three countries' governments. This difference presented not only distinguishes ideologies among States in terms of management policies but also how the countries' institutions influence in shaping different microfinance institution models in the three countries as well as differences in the degree of

freedom of microfinance regulation. According to the perspective constructivism and constructivism perspective, State's preferences and the way it shapes its policies, law, rules, norms and institution point out to its deep-rooted value and belief system. The State is not only political actors but social ones as if it has mind and soul of its own. This is the reason why States choose different paths to development, adopt specific policies in their unique ways shaping their own socio-economic-political-legal context, a distinctive dominant ideology, a special set of cultural values and a governance structure. Microfinance is likely to fall into the rubric of those industries that require strong local adaptation than global standardization. Microfinance institution can be profitable in some suitable conditions but it is unlikely that any single business model will work with the same success across all business environment. Although both Vietnam and Bangladesh follow microfinance for social development approach, the way to control and manage microfinance industry of the two States are different. In Vietnam, Government uses dual approach: market-drive and state drive to control and deal with microfinance problems while the State of Bangladesh applies financial deregulation, letting the market drive rather than making State expressive influences on microfinance operation which has some similar features with the ways the Indonesian State does in managing their commercial for-profit microfinance. Thus, it needs a separate set of regulation. Microfinance institutions are not commercial enterprises but social businesses. That point of view leaded to the establishment and operation of Grameen Bank under special Grameen Bank Ordinance 1983 as a specialized bank to serve the rural poor. It is a private bank with private citizens comprising the majority of its Board Members and its shareholders. The Board of the Bank, not the Government, is the competent decision-making body. Grameen Bank is not, therefore, expected to conduct its operations in the same manner as nationalized or other government-owned banks to which their own laws apply. Grameen Bank's Board operates independently, innovates freely, free from regulatory

intervention. In Grameen Bank, work is not focused on head office, they apply direct customer approach. Trust is the strong management system. Among microfinance institutions in the world, Grameen bank seems to enjoy the most freedom in regulation, its only limitation is asking for permission from Bangladesh Bank when opening new branches if any. Bangladesh Bank supervises Grameen Bank's operation but do not interfere into its business activities. Supervision is conducted through collection of all kinds of information from Grameen Bank on a regular basis in prescribed formats with a view to closely monitoring the activities of Grameen Bank or on-site inspection visits and recommendations made related to the Bank's management. Until now, there is no law in Bangladesh that limits the rates. However, with the view of microfinance for development target, the Bangladeshi Government has fixed the interest rate for government-run microcredit programs at 11% at flat rate. It amounts to 22% at declining basis. Although being not a state-owned bank, Grameen Bank's interest rate is still lower than the government rate with different rates on each loan scheme: 20% (declining basis) for income generating loans, 8% for housing loans, 5% for student loans. The board of the Bank sets the interest rate such that after paying all expenses, including the cost of its growth, the bank makes a modest profit. The profit is returned to the shareholder-borrowers in the form of dividends. Although there are still many controversies in the way the bank computes the credit interest rate, on balance, Grameen bank loan seems to be pretty cheap particularly in the fact that the bank applies 0% (interest-free) loans for Struggling Members (beggars).

In Indonesia, commercial banking has been a long tradition. Different financial providers are converted by different regulators and regulations. This is as much the result of the historical development of these different institutions as it is about differences in products they offer. Bank Rakyat is one among state-owned traditional commercial banks, under Indonesia's banking laws, the bank operates under the supervision of the central bank which have the role of

maintaining the stability and value of the rupiah, governing the smooth functioning of the payment system and regulating deposit-taking institutions, particularly banks. The appearance of microfinance unit desa network in the Bank Rakyat is indeed as the new form of commercial bank entering the microfinance market. It is considered as the microfinance operating division of the bank. The organizational structure of the BRI is a 4-tier layers in which the village unit division of BRI is in the bottom tier, but the microfinance division of the bank is separated and independent of BRI large commercial banking network. BRI units desa system has been able to operate autonomously and stayed free from government intervention such as credit targeting, interest rate restrictions or any interference in lending decisions. Only commercial credit is to be available at the units. Although the government decided not to stop the credit subsidies at BRI but limited them at branches at the district level in order to take subsidies out of the units and let market forces operated there, all unit desas can enjoy the deregulated interest policies and transferred in to self-dependent profit centers and received the management directly from head office. Leaders of the village-based unit can decide and adjust the interest loan basing on the real market.

While Grameen Bank in Bangladesh follows microfinance for social development and BRI bank, Indonesia applies microfinance for profit approach, Vietnam's microfinance is somewhere between the two. With the dual approach of market-based and state driven in microfinance management, the Vietnamese Government directly participates in providing microfinance services in rural areas. The two largest banks working in the field of microfinance are the Vietnam Bank for Agriculture and Rural Development and the Vietnam Bank for Social Policy (VBSP), which are both state-owned. They are supervised by the State Bank of Vietnam under the Law on Credit Institutions. Most other non-governmental organizations have heavily involvement with mass organizations which are intertwined with the government and are also

subject to interventions by local government officials. The interference of the government in microfinance activities is for the purpose of keeping microfinance not going out of the social business target, helping eliminate poverty all over the country. It has advantages of distributing the Government's lending programs to poor customers in a lowest bottom of the society, understanding local conditions. Even BRI although followed profit targeted commercial microfinance, still didn't stop their subsidized lending. But instead of implementing in unit levels the bank confined to branch levels in order to maintain financial health and credit discipline. In Vietnam's case, the VBSP is established for the State's objective of serving policy targeted customers particularly extreme poor in remote disadvantage where really need the Government's assistance and out of outreach of commercial banks due to unprofitable. However, after running operation for a while, together with the fact that there isno clear classification criteria in rating poor for targeted policy clients, VBSP with subsidized loan fund and interest has raised concerns from economic researchers about risk of distorted market due to uneven field for competitions between stakeholders as well as other issues such as moral hazard, high loan defaults and eroding State's Budget. The participation of local mass organizations could lead to inequality in executing the business operation due to corruption, cumbersome procedures or management teams who are lack of knowledge in banking, accounting and microfinance market. For formalized microfinance institutions (MFI), the State Bank of Vietnam has imposed an interest rate ceiling, whereas semi-formal MFIs have to comply with the Civil Code. Accordingly, the negotiated interest rate has been applied since 24 November 2014, but should not exceed 20% per year, excluding those loans stipulated in other laws or regulations. With that regulation, Vietnamese national regulators hope to avoid fraud on the black credit market that often saw heavy rates and brought negative consequences to the society. However, the question is: does the new Government's ceiling interest rate can help Vietnamese institutions

cover all their operation costs, cost of fund, loan loss provisions and earn profit so as to continue and expand their business. According to CGAP, compared with international standards, microcredit interest rates in Vietnam are lower than the average of 27% per annum globally in the rest of the world while in Vietnam microfinance institutions' revenues come mostly from microcredit, other microfinance products and services are not very popular.

It is not possible to know which microfinance model is the best: Stated-owned ones, private ones, commercial banks, non-government institutions or credit institutions with cooperation with social mass organizations. Indeed, basing on the institutional distance theory, basing on specifics of each nation, one model can work well in one location and the other in another location, and some locations maybe so institutionally divergent that microfinance may not work at all, and in which case public welfare or grant programs may remain the only viable option? In the cases of Grameen Bank, Bangladesh and Vietnamese microfinance system, it seems that in less developed economies like Vietnam or Bangladesh where there are still few social welfare conditions, high rate of extreme poor or middle poor in population compared with other level but high value of community ties and strong social enforcement, States tend to have dual targets: poverty elimination combined with improving the living standard by supporting social welfare services. In that context, non-profit microfinance institutions have conditions to better grow because of the participation of other social partners besides microfinance institutions and their ways of doing microfinance business go in line with States' development views, while commercial microfinance growth should be likely more suitable in the economic contexts where small scale production networks operate in a relatively stable manner under high political economic stability to ensure the conditions of basic survival for its participants. Ault Spcier also suggested that there shouldn't be convergence on a single model. Non-profit, for-profit, traditional banks, group lending, solidarity group, village banking…can exist or alternate each

other to dominate that depends on local needs to expand microfinance's reach and avoid dependence. Regulations and development directions from States still have and remain a significant role to contribute to the foundation of microfinance institutions at initial phase and the choice of States in microfinance approach decides the way they operate in the microfinance market. For the sustainability of the microfinance sector to be integrated into the financial industry of a nation, we need the favorable conditions in regulation from States to support microfinance operations. Although changing regulations from State levels has been a long and complicated process, the relationship between microfinance institutions and States of the host countries are a two-way interaction, microfinance start-up institutions could develop until some certain points where their maturity will react to State regulation, requiring for a necessary change in policies to motivate their growth further.

Difference in microfinance objective leads to targeted customer area of BRI bank is more flexible in comparison with the other two however, the bank limited in traditional banking services and products while the two others contribute to deal with other social development issues such as gender equality. Grameen Bank as well as microfinance system in Vietnam especially VBSP focus on poorer and women clients while microfinance village-based system of state owned commercial BRI Bank considered their clients are anyone-not only farmer but trader, worker…who has potential to save and pay loan. With that way of doing business, BRI's customer base are majority middle poor or better off who are not very poor and always have demand of borrowing to expanse their household business. In contrast, microfinance in Vietnam and Bangladesh through Grameen Bank move beyond microcredit to other development services like women empowerment, education, health and hygiene… Particularly in Vietnam, a microfinance institution called "Vietnam Woman Unions" provides Vietnamese women in rural areas chance to access to financial services, trains to become chef in their household businesses.

If institutional environments gave momentums to frame and reform various kind of microfinance institutions models through regulations and policies from States' level, the sustainability of microfinance institutions in long term depend mostly on their internal financial innovation such as product and process innovation to be compatible with the local needs. However, in comparison with Grameem Bank and BRI bank, Vietnam microfinance institutions are less flexible particularly in products innovations as well as finding alternative solutions for their financing source troubles. Microfinance institutions in Vietnam mainly offer traditional products such as loans and savings. Among the latter are savings account for very modest part. Some semi-formal NGO MFIs provide remittance payment and transferring money but it is still limited. Micro insurance products are almost young and not popular among poor clients. Grameen Bank on the other hand, diversifies their products and services for all demand of their clients: apart from offering microcredit loans as a core product it also offers micro-saving, micro-insurance and pension fund. Their staffs are always close to market to find and catch clients' taste and report to the bank to adjust their products and services on time. In realising the higher climatic risk faced by the agricultural activities, the bank offers micro-insurance that are welcome by farmer clients. Micro-insurance not only reduces the burden on the borrowers when a disaster happens but also saves the financial accounts of the Grameen Bank from deficits caused by uncollectible loans. Other microfinance products offered by Grameen Bank are pension funds and scholarships to the outstanding children of the borrowers. The pension fund is designed to help the poor to build a nest egg for their old age. Among the subsidiary microfinance products offered, the Grameen Bank pension fund savings programme is the most successful programme in the Grameen Bank (Yunus, 2007b). In 2007, total deposits in the pension fund amounted to USD 400 million, which represented 53% of the total deposits in the bank (Yunus, 2007b). Not having various kind of products like Grameen Bank but saving and

loan product of BRI bank Indonsia are designed based on research and market's survey on customer's need. That is reason why their two main products Simpedes and Kupedes are well-known all over the country and become the most attractive banking products. With saving products Simpedes, the poor can enjoy no fee to open account, no minimum balance, no compulsory deposits or withdrawal restrictions and interest paid monthly on all but the smallest balances (less than 10USD). All Simpedes accounts link to Bank's bi-annual lotteries that are held in bank's branches; winners and local people are located within a small area so they know each other and make the product schemes popular.

Funding source has also been considered as critical requirement in determining the growth and overall health of microfinance organizations. In order to finance their lending and meet other financial and social objectives, microfinances institutions need to find ways to access to funding. While Vietnamese microfinance institutions is still financial dependent, Grameen Bank in Bangladesh and Bank Rakyat, Indonesia are the two big microfinance leading self-sustainable organizations in the world. They overcame the obstacle of funding resource limitation in their own ways. Grameen Bank chose to diversify their banking products and services to earn revenues for their lending fund and cover the cost of their operation. Besides, Grameen Bank tried to seek financing in local market by issuing bonds and debentures, increasing saving deposits from member and non-member clients. Instead of disbursing more capital as loan, the bank moved to earn profit by increasing fix deposit Investment in local commercial bank. Grameen Bank can also seek to borrow capital from Bangladesh Palli Karma Sahyak Foundation (PKSF), a wholesale for the expansion of microcredit programs if any. Unlike Grameen Bank, funding resource for loan portfolio in Bank Rakyat, Indonesia comes from public saving. Saving mobilization has been an integral part of the unit banking philosophy and strategy. The bank applied compulsory saving accounts together with other kind of voluntary savings. Realising

that not all borrowers are able to go to the bank regularly because of their family commitments as well as transportation constraints. BRI' staff took the initiative go to the borrower's house or business premises on a daily or weekly basis to collect their savings. Besides, BRI was among the first microfinance institutions taking part in capital market. The bank lists in the national stock exchange and sold internationally. The success in stock market brings to the bank the chance to raise their capital to invest in business expansion.

4.5   CONCLUSION

What draws this chapter is the rise in popularity of microfinance services worldwide and the need of Vietnam microfinance development toward self-dependent sustainability. It is helpful to chalk out similarities and differences in practices and model types as well as the socio-economic and political construct of a society that chooses and adapts them. As previously said, microfinance is not a "one size fit all" solution so it is not easy to apply microfinance model from one land to another, the chapter emphasizes the role of flexibility and adaptability in microfinance innovation among countries in which market-drive and customer-centralized are key factor that can lead to the success of microfinance operation. The article once more time supports for the argue that there is no better than the other: not-profit or for-profit commercial institutions. All type of microfinance institutions can exist or alternate each other to dominate that depends on local needs and even in the same countries several kinds of microfinance institutions can be operated at the same time if they are suitable and adapted with State's host country. The important things are State law regulators should find the ways to create a favorable and fair playing field for all interested participants. Otherwise it could be constraints for the development of their own microfinance industry. Besides significant role of State levels, the article also confirms the decisive role in self-innovation of microfinance institutions through introduction new products, services or their financing process for their long-term sustenance.

Being adaptable with institution environments and continually innovating in conducting business operations as well as introductions of new products and services as local needs are successful secrets of all leading microfinance organizations in the world.

Table 21 : Summary of comparison of Vietnamese microfinance institutions, Grameen Bank and the Bri Bank

	Vietnamese Microfinance Institutions	Grameen Bank, Bangladesh	Bank Rakyat (BRI bank), Indonesia
Characteristics	State subsidised and Control	Unsubsidised and State deregulation	Unsubsidised and State deregulation
Source of operation	-Government grants and soft loans -International donor grants -Interest rate -Savings (but not much)	-Interest rates -Saving -fixed deposit investment in other commercial banks -selling share to its borrowers to raise equity	-Interest rate -Saving -published in capital market and sold international to raise fund
Products offer	-Traditional loans and savings products -Other microfinance services and micro-insurance are not underdeveloped	-Microcredit -Microsaving -Micro-insurance -Pension Fund	-Microcredit -Microsaving
Interest rate	Negotiated	Different on each loan schemes	Applied fix flat rate for loan product but real interest rate for saving products.

CHAPTER 5

DETERMINANTS OF FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN VIETNAM

5.0   INTRODUCTION

Most Microfinance Institutions deal with a double bottom line: try to reach financial sustainability and increase their socioeconomic impact at the same time. Microfinance institutions are therefore hybrid but they are similar to banks because they are also regulated, supervised and, for some MFIs, they can collect deposits. This operational diversity makes any empirical analysis of their performance difficult (Cull 2009a). Moreover, MFI's financial performance data has been considered as proprietary and hard to obtain. It is clear that, for achieving good finance performance, microfinance institutions should comply with specific rules, which are necessary for them to exert a positive impact on the welfare of poor people. Unfortunately, not all MFIs have been successful. Some MFIs have found their own way to financial viability or sustainability while many of them have failed in this effort. Various reasons have been cited for this failure or success although not conclusively. Thus, financial performance of microfinance institutions has been one of the issues that recently captured the attention of many researches throughout the world. This chapter is an attempt and a response to the need for a better understanding of the determining factors of microfinance profitability in the case of Vietnam. This study presents some evidence on the link between microfinance profitability, on one hand, and firm-specific, industry-specific, and the macroeconomic context, on the other hand.

5.1   LITERATURE REVIEW

Many studies have been conducted to determine the factors affecting the performance of MFIs in various countries. Most of them employed quantitative analysis methods going from simple to multiple regression with various sets of measurement factors applied to large and well - developed MFI samples. However, the level of significant of these factors varies with studies: some are found to be significant in one economy or applicable to a set of MFIs, some are not significant on different sets of data. In existing literature, the level of sustainability is measured through many different financial indicators such as the Subsidy Dependency Index (SDI), suggested by Yaron in 1992, or through other similar indicators such as the Explicit Subsidy Dependency Index (ESDI) or the Implicit Subsidy Dependency Index (ISDI). Other more common measures are the standard financial indicators such as returns on assets (ROA), returns on equity (ROE), adjusted return on assets (AROA), adjusted return on equity (AROE), operational self- sufficiency(OSS); financial self-sufficiency (FSS). They have been calculated and applied in different ways among researchers depending on their goals and methodological choices.

Christen et al (1995) conducted a study on eleven successful MFIs using several simple regression models (one independent variable) with eleven observations each. However, it examined only successful MFIs and ignored the simultaneous effect of other relevant determinants of financial sustainability, which led to biased estimates. Moreover, the number of observations was too small to achieve statistically reliable conclusions thereby raising questions on the, generalizability of the results. Later, in 2000, Christen modified methodology from simple to multiple regression models to determine factors influencing financial sustainability of MFIs using financial parameters on Micro Banking Bulletin (MBB) data. In his research, Christen argues that commercialization, which is characterized by profitability, competition and

regulation does not have any effect on large differences in loan size between regulated and non-regulated MFIs.

Woller (2000) studied factors driving the financial self-sufficiency of nine village banks in South America countries such as Colombia, Mexico, Nicaragua, Uganda… He used financial ratio analysis and a series of bivariate correlations between financial self-sufficiency and nine indicators of financial self-sufficiency in the sampled institutions. The methodological weakness of this study is that the simple correlation just indicates whether or not two variables move together in the same or opposite direction. It does not necessarily mean that one should be causing the other (Mcclave 2008, Sincich 2008, Dietman 1991). Two variables may be positively correlated just because a third variable cause them to behave in that way

Schreiner (2002) expanded the outreach variable to what he called seven aspects of outreach by integrating the financial and social parameters in microfinance financial sustainability. With the cooperation of Woller the same year, they examined determinants of financial self-sufficiency using thirteen village banks. This study improved the previous methodology by adding the number of institutions to thirteen and time period of study to three years and focusing on aspects of outreach proposed by Schreiner. However, more than 60 per cent of studied MFIs were presented FINCA-a non-profit microfinance organizations which uses a village banking model, a model different from other microfinance institutions studied, leading to bias in the study. The study analyzed the relationship between outreach and financial sustainability and found that interest rates, administrative efficiency, loan officer productivity and staff salaries, are determinants of financial self-sufficiency. Insignificant variables include all other staff productivity measures and institutional scales. The finding thus both confirm and contradict the best practice consensus by the absence of influence of the number of borrowers in terms of financial sustainability. Probably, the most notable finding of the study is that the average loan

to GNP per capital GNP is inversely associated with financial self- sufficiency, suggesting that providing loan to the poorest is possible and can be sustainable.

Olivares-Polanco (2005) focused his study on commercialization and outreach on 28 Latin American MFIs. The study used OLS multiple regression analysis to investigate where tradeoff between depth of outreach and financial sustainability exits by exploring the determinants of loan size. The methodological weakness of this study is that the analysis did not have multi-period observations and was dominated by a simple regression approach. It included only one observation from each MFI for two different years. The results of the regression indicated that the type of institution in terms of NGO versus financial institutions, regardless of being regulated or not, has no effect on loan size. However, competition and the age of the institution turned out to be significant for predicting loan size scale. The models confirm an old belief in microfinance according to which there is a trade-off between depth outreach and sustainability.

The study by Makame and Murinde (2006) was set to explain cognitive dissonance around microfinance outreach and sustainability. Specifically, this study was meant to show how the microfinance outreach and the sustainability levels are explained by commercialization factors. The study is based on the work by Olivares-Polanco (2005). Instead of a single period cross section analysis, Makame and Murinde introduced a balanced panel analysis to overcome the methodological weaknesses in Olivares-Polanco 2005. This study was based on data obtained mainly from microfinance information exchange (MIX) organization for 33 MFIs in four East African countries in 6 years. The study therefore excluded MFIs which are non- members of the market MIX which could have enriched it. This result is consistent with the finding of Olivares Polanco 2005 about the old belief of mission drift and inverse relationship between age of microfinance institutions and average loan. Although data utilized in the study suggest that regulation and profitability (ROA) appear to be not significant in explaining the depth of

outreach in their regression, the significant influence is enough to show that the higher the ROA, the lower average loan and vice versa and regulation is positively related to average loan. The study also confirmed that operational and financially efficient MFIs are likely to produce a positive and larger ROA, and that a microfinance institution can be efficient while at the same time using subsidies. These researchers concluded that MFI oriented toward efficiency may be allocated subsidies so that will ensure that they will not loosen their standards.

Cull et al (2007, 2009) explored pattern of profitability, loan repayment and cost reduction among the sample of 124 MFIs from 49 countries. They used multiple regressions models, focusing both on financial performance and outreach, using three dependent variables (financial self-sufficiency, operational self-sufficiency and return on asset) with a limited number of independent variables. The study gives some empirical evidence for a trade- off between the depth of outreach and profitability by examining whether more profitability is associated with a lower depth of outreach and whether there is a move from serving the absolutely poor to wealthier ones in order to achieve higher profitability. The results showed, firstly, that individual-based lenders performed better than group-based lenders and, secondly, that an increase in the lending rate affects the loan portfolio due to adverse selection and moral hazard. further research by Cull et al in 2009 analyzed different aspects of MFIs, particularly their different legal status. NGOs and banks are compared for explaining the different motives, capital structure, operation costs and efficiency. regarding sustainability, they do not find that the average cost per loan influence the financial self-sufficiency of MFIs.

Bogan, Johnson and Mhlangay (2007) define an MFI being financially sustainable when OSS reaches 110%. Their method may be seen to be a reasonable one when analyzing a single country with certain characteristics. The model used a sample of 300 top assets MFIs in Africa,

East Asia, Eastern Europe, Latin America, the Middle East and South Asia. A cross-country analysis was carried, not taking into account the different levels of debt and inflation rates in countries, leading to bias and substantial errors. Moreover, in computing OSS by the ratio between operating income and operating expenses including financial costs, the authors did not add the provision for loan losses. This is another issue for discussion. In fact, the definition of operational self-sufficiency varies among different MFIs and donors. Some researchers use the formula: OSS = operating income/ (Operating Cost+ Loan loss provision + Financial cost)[42]. The difference centers on the inclusion of financing costs due to the argument that not all MFIs incur financing costs equally. Some MFIs fund all their loan portfolio through concessional loans, donations or grants, do not need to borrow funds or collect saving and thus do not incur any financing costs. While some others as they move progressively toward financial viability are able to access concessional or commercial borrowing and thus incur financing costs. The choice of formulas is personal because they are both correct, however, all MFIs incur operating expenses and the cost of making loan loss provision and they should measure on management of these costs. The research began by assuming a link between the theory life cycle and the development of MFIs. It was assumed that in the formative stages, the funding sources of MFIs come mainly from donor grants or soft loans, and turn into private debt capital with restrictive covenants and/or guarantee when they mature, and then finance by the availability of traditional equity financing in the last stage of MFI evolution. But the results showed that various factors rather than life cycles seemed to be linked to sustainability. Such factors are the size of MFIs assets and capital structure. The ratio of debt relative to assets is found to be negatively related to financial sustainability and grants in the opposite with the MFIs' expectations is factor that hinder the development of MFIs into competitiveness and sustainability. Among other factors

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[42] The formula is given in Microbank Bulletin Issue No.8, November 2002.

analyzed, no regional differences have been found significant among five sub-continents under study. Furthermore, no influence was found by the sustainability related on the legal status and lending types (individual or group) chosen by MFI.

A recent study by Kyereboah-Coleman and Osei (2008) examined how governance indicators impact microfinance institutions 'outreach and profitability performances. This study used a panel data analysis based on secondary data obtained from 52 conveniently sampled MFIs operating in Ghana for at least ten years. However, with the view that the presence of debts exerts pressure on management for efficiency, profitability, sustainability and the debt payment obligations, this study focused only on the role of governance on profitability and outreach of microfinance institutions. Thus, other factors that could affect outreach and profitability were not covered. But Coleman and his colleagues are among first researchers who tried to fill gap studying the impact of capital structure on the performance of MFIs in developing countries (Ghana). They found that debt has a positive impact on performance, and that the high leverage is positively related to the outreach. Coleman and his colleagues defined outreach as the annual change in the customer base than total number of clients. Their findings showed that the higher leverages cause a bigger expansion of the clientele base and therefore a higher premium which translates into an increased profitability for the institution which can be further used to service the debt. Moreover, the results of Coleman showed highly leveraged MFIs perform better in reduction of annual default rates and enjoy scale of economies and thus, they are in a better position to deal with moral hazard and adverse selection.

Adongo and Stork (2010) refer to the calculation of a break-even interest rate to derive the financial sustainability of MFIs in Namibia. They use the residual, break-even, interest to represent financial sustainability given by the Usury Act maximum rate and the break- even interest rate required by the MFI to achieve sustainability. The last interest rate envisions that a

financially sustainable MFI will need to cover its costs and risk provisions frim the interest income that it generates. This approach might be questionable because it assumes that a MFI generates only income from interest on loans. In fact, other studies demonstrated that in average MFIs do earn only 90% of their revenues from loan portfolio related activities (interest, fees) whilst the remaining 10% is generated from other activities (Gonzaler 2007). In the context of Namibia, researchers found that the status of institutions affected negatively the sustainability of MFIs, particularly multi-cooperatives joining together because they operated less efficient. They provided both financial and non-financial services but didn't separate the cost of the two different kinds of services. The result also showed a further positive relationship between financial sustainability and start up fund of MFIs from donors. But in opposed to the theoretically posited relationship between group lending and sustainability, empirical study in Namibia evidenced that MFIs who give loans to individuals are more sustainable than those dealing with lending groups. Besides, external factors such as low per capital income doesn't influence the sustainability of MFIs but the regulation factors. Adongo and Stork said that the lack of regulation is a concern for microfinance providers. It is necessary to provide a clear strategic direction and ensure a conductive environment for the development of the microfinance sector.

Peter Muriu (2011) is among pioneers in using dynamic system GMM (generalized method of moments)- new methodology currently in use in the empirical investigation of the financial performance in banking and finance. The analytical framework uses an unbalanced panel dataset comprising of 210 MFIs across 31 countries operating from 1997 to 2008 to examine which are determinants of microfinance profitability (ROA is used as proxy for MFI's profitability). The estimation results show that MFIs that employ a higher level of deposits as a ratio of total asset is associated with improved profitability, assuming that the deposits program is cost efficient.

Additionally, MFIs with higher portfolio-assets ratio are more profitable but impact depends on MFI age. The study concludes by drawing some policy implications geared towards access to long-term debt to enhance microfinance profitability and to strengthen the financial stability

5.2   OBJECTIVES OF THE STUDY

Previous studies have some gaps such as few researches on MFI's profitability in developing countries with particular economy and political structures; research analysis methodologies are based on linear models in order to measure the effect of numerous internal and the overall banking environment factors on profits. Although their results may be adequate for identifying the determinants of profit, it seems not sufficient due to the fact that most of them focus on static models, and thus do not account for some features of profit (persistency of profits for example). In this study, both dynamic and static models are employed to examine factors affecting microfinance institutions' profits in order to check the robustness of the estimation.

In existing literature, profitability is usually expressed as a function of both internal domestic and external determinants. Internal factors originate from financial institutions' accounts (balance sheets and/or profit and loss account) and can be called as MFI-specific factors. External factors which are not related to the managerial decisions but reflect the macroeconomic and legal operation environments, also affect profit of the MFIs. Learning from previous empirical work, this study will also investigate in a single equation framework the effect of MFI-specific, industrial-specific and macroeconomic determinants on MFI's profitability:

1.   To asses and analyze the extent of MFIs-specifics such as Capital Asset ratio, portfolio quality, gearing ratio, size, type of microfinance institutions affects financial performance of MFIs in Vietnam

2.   To analyze the effects of external or macroeconomic such as level of GDP, inflation rate

on financial performance of MFIs.

The study will test some following hypothesis:

1: Financial performance is positively related with capital Asset ratio of MFIs in Vietnam

2: Portfolio quality and financial performance of MFIs are inversely related.

3: MFIs financial performance is in a positive relationship with MFIs size.

4: Gearing ratio is negatively related with the financial performance of MFIs.

5: Real GDP is positively related with the financial performance of MFIs

6: Inflation rate is negatively related with the financial performance of MFIs

Table 22 : Literature Summary.

Author and year of publication	Country coverage	Method	Dependent variables	Independent Variable	Direction of effect	Supplementary information
Christen et al (1995)	11 successful microenterprise finance programs from Senegal, Dominican Republic, Bolivia, Indonesia, Niger, Colombia,	Comparative analysis of actual program and financial results Simple regression with one independent	Return on asset (ROA)	-Loan size	+	-The study demonstrated no clear trade-off between reaching the very poor and reaching large number of people
				-Number of borrowers (mainly female clients)	+	
				-Loan Loss	-	
				-Administrative expenses	-	

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	Costa Rica, Bangladesh, Kenya,	variable		-Operation Expense	-	
				-Saving Deposits	+	
				-Interest Rate	+	
Christen et al (2001)	Latin American	Comparative analysis	Profitability (ROA) Competition (market penetration rate) Regulation (Type of MFI-Regulated or Non-regulated MFIs)	Number of Loan outstanding		which is characterized by profitability, competition and regulation does not have any effect on large differences in loan size between regulated and non-regulated MFIs.
				Loan delinquency		
				Type of products		
				Average Outstanding Loan balance as a percentage of GNP per capital		
				Number of clients serves		
Woller (2000)	Nine village banks in Colombia, Mexico, Nicaragua,	Simple OLS Simple correlations among	Financial Self-Sufficiency (%)	Portfolio Yield (%)	+	There are three indicators have large and statistically significant correlation coefficients with Financial self-
				Interest Spread (%)	+	

	Uganda, Kyrgyzstan, Mali, Honduras	sample of 9 village banking institutions		Administrative Expense/Average Loan Portfolio (%)	-	sufficiency: portfolio yield, interest spread, number of borrowers. Although these are only simple correlations and do not imply causation but the strength of the correlations relative to those other indicators suggests that for FSS, both the interest rate and scale appear to matter most, indicating that for achieving FSS, village banks should charge high interest rate at an adequate spread over costs and scale up.
				Salary Expense/Average Loan Portfolio (%)	-	
				Cost per Borrower (USD)	-	
				Staff Productivity (No.)	+	
				Depth (%)	+	
				Salary Structure (multiple of GNP/capital)	+	
				Number of borrowers	+	
Schreiner (2002)	13 village banking institutions from Colombia, El	Panel regression	Financial Self-Sufficiency	Administrative expense ratio		
				Real portfolio yield		

	Salvador, Ecuador, Honduras, Kyrgyzstan, Malawi, Nicaragua, Peru, Uganda, Bolivia, Tanzania, Togo			Cost to borrower ratio		
				Staff productivity		
				Loan officer productivity		
				Staff location		
				Average staff salary		
				Portfolio at risk		
				Borrowers		
				Average Loan		
				an to GNP		
Olivares-Polanco (2005)	28 Latin American MFIs	OLS multiple regression	Loan size	Type of Institution	No effect	The experiment test confirmed a trade-off between profitability and depth of outreach
				Age of Institutions	–	
				Sustainability (ROA)	–	
				Number of active	Not clear	

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				clients		
				Competition (market share ratio)	+	
				Gender (pct of women clients in portfolio)	Not clear	
				Credit Methodology	Not clear	
				Regulation	No relationship	
				Efficiency	Implied negative	
Makame and Murinde (2006)	33 MFIs in East African Region	Panel regression	Average Loan Outstanding	Return on Asset	+	
				Efficiency	-	
				Regulation	Not significant	
				Average outstanding borrowers	Not clear	
				MFI staff	+	

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				Competition	-	
				Age	-	
				Cost per borrowers	-	
Cull et al (2007,)	129 MFIs in 49 countries reported financial information on MIX	Panel regression	FSS, OSS, ROA	Portfolio yield	+	No clear evidence about mission drift
				Labor cost	Not clear	
				Capital cost	Not clear	
				Loan size	Insignificant	
				Age		
				Size of MFIs		
				Lending Type	Individual lending +	
				Women Borrowers	No effect	
Bogan (2007)	Top 300 MFIs reported on MIX	Profit regression	OSS, FSS	Debt/Asset	-	MFI should rely on less grants, soft loan and other type of donor funds.
				Grant as percent of Assets	-	
				Share Capital	-	
				Type of MFIs	Insignificant	

				Regulation	Not all significant	
				Age	-	
				Portfolio at Risk	Insignificant	
				Region		
Kyereboah-Coleman and Osei (2008)	52 MFIs in Grana					
Adongo and Stork (2010)	Selected MFIs in Namibia		FSS	Donor Involvement	+	
				Group lending	-	
				Per capital income	No effect	
Muriu (2011)		GMM	Profitability (ROA as proxy of profitability)	Portfolio to Assets	+	
				Deposits to Assets	+	

				Debt to equity	Indeterminate	
				Capital (equity/asset)	+	
				Portfolio at risk	_	
				Efficiency	_	
				Age	Indeterminate	
				Size (total asset)	Indeterminate	
				Loan size	+	
				Share of women borrowers	+	
				Inflation	Indeterminate	
				GDP	+	
				Rural Population	-	
				Population growth	_	

5.3   METHODOLOGY

According to Creswell (2003), there are three common approaches to conduct a research namely, quantitative, qualitative and a mixed method approach. Quantitative research is a way for testing objective theories by examining the relationship among variables. On the other hand, qualitative is a means for exploring and understanding the meaning individual or groups ascribe to a social or human problem with intent to developing a theory or pattern inductively. Mixed methods help emphasize the research problem and use all available approaches to understand it. These approaches are often utilized in empirical research to collect and analysis data to make a general statement about a certain issue on the world based on a sample of observations. In this chapter, our goal is to test the applicability of existing theories (what is already known and found in other studies) to MFIs in Vietnam by analyzing the factors affecting the relationships between variables. Thus, our solution is an empirical quantitative approach which is built basing on the methodology used in previous studies in microfinance (Muriu 2011, Kyereboadh-Colemand and Osei 2008, Cul et al 2007, Anathasogolou 2005, Woller and Schreiner 2002): employing multiple regression models to investigates the role of internal and external factors on MFI's profitability.

A cross-sectional and longitudinal panel methodology is utilized to achieve our stated objective because of advantages such as: panel data is generated from large observed sample individuals which enhances tracking changes in constructs (measured variables) and relationships overtime. Panel data can better detect and measure effects that simply cannot be observed in pure cross-section or pure time series data longitudinal.   The techniques in panel data estimation allow us to control for certain unobserved characteristics of individual institutions and facilitate causal

inference in situations of short time period panel. Therefore, panel data give "more informative data, more variability, less collinearity among variables, more degrees of freedom and more efficiency"; In addition, by studying repeated cross-sectional observations, panel data is better suitable to study the importance of lags variable for dynamic changes. The five years' period is selected even though the age of studied sample of MFIs is over 5 years because it is the period within which relevant data can be obtained. The study is based on linear functional forms without any test because of widely used approaches and good results in literature (Athanasoglou et al 2006, 2008; Muriu 2011…). Our empirical analysis is conducted using Stata econometric software because of it is a user-friendly and an effective analysis tool for researchers. It has online technical support and learning resources which make its use more convenient. It is also recommended and commonly used in literature: "the use of STATA makes the task of implementing panel data regression quite easy. (Gujarat 2003)

5.4   DETERMINANTS OF FINANCIAL PERFORMANCE

The focus of this chapter is MFIs financial performance. According to CGAP, financial performance is one of the indicators used to measure the success of microfinance institutions in terms of its financial returns. It is often considered as a yardstick used by investors to conduct due diligence and assess the status of an investment; it is also used as the tool by government supervisors to assess compliance with regulatory measures and monitor the overall health of the financial sector. All MFIs, from non-profit NGOs to profit-oriented microfinance institutions must have a good financial performance, i.e., must be profitable over the long-term in order to be self-sustaining. Profitability allows an MFI to continue operating and to grow.

Profitability means ability to make profit from all the business activities of an organization,

company, firm, or an enterprise. It shows how efficiently the management can make profit by using all the resources available in the market. The term Profitability however is not synonymous to Efficiency. Profitability is a measure of efficiency and is an important yardstick for measuring efficiency. However, the degree of profitability cannot be taken as a final proof or indicator of efficiency. Sometimes satisfactory profits can mark inefficiency and conversely, a proper degree of efficiency can be accompanied by an absence of profit.

Although people often use the term 'Profit' and 'Profitability' interchangeably, there is a difference between the two terms. Profit is an absolute term, whereas, the profitability is a relative concept. However, the two terms are closely related and mutually interdependent, having distinct roles in business. Profit refers to the total income earned by the firm during the specified period of time, while profitability refers to the operating efficiency of the firm. It is the ability of the firm to make profit on sales. It is the ability of firm to get sufficient return on the capital and employees used in the business operation. There are different ways to measure profitability such as: return on asset (ROA), return on equity (ROE). Return on Asset indicates of how profitable a company is relative to its total assets. It gives an idea of how efficient management is in using its assets to generate earnings. On the other hand, return on equity measures a company's profitability which shows how much profit a company generates with the money shareholders have invested. This measure gives a sense of how well company is in using its money to generate returns.

A vast literature posits that MFIs, to achieve full potential, must become financially sustainable. Financial sustainability indicates the ability of an MFI to survive in the long- run by means of its own income generating activity without any contributions from donors. To analyze the

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sustainability of an MFI, economic researchers often use two of the most important ratios which are Operational Self Sufficiency (OSS) and Financial Self -Sufficiency (FSS).

OSS (%) = Operating income/Operating Expense

OSS> 100%: The organization is considered to be operationally self-sufficient

FSS= Adjusted operating income/ Adjusted operating expenses

Operational self-sustainability is when the operating income is sufficient enough to cover operational costs like salaries, supplies, loan losses, and other administrative costs. And financial self-sufficiency indicates whether or not enough revenue is earned to cover all the operating, financial and loan loss expense as well as to maintain the value of quality and quasi-equity in the organization in relation to inflation. Financial self-sufficiency (FSS) is the adjusted version of Operational Self-Sufficiency. It requires adjustment because financial statement must conform to standard accounting practices and to take account of inflation as well as of the remove of effect of subsidy and donations. Unless 100% FSS is reached, the long- term provision of credit services is undermined by the impact of inflation and the continued necessity to rely on donor funds.

The Microfinance Financial Reporting Standard recommends the use of ROA and ROE as measures of MFI profitability rather than OSS and FSS. OSS and FSS were the earliest attempts to measure whether an MFI could cover its costs and maintain it program. As the microfinance industry evolved, MFIs began using more commercial approaches to measure financial viability or profitability. This included more traditional financial measures such as return on assets

(ROA) and return on equity (ROE). The two indicators are financial metrics that are well established and well understood across the commercial spectrum. As such, they are useful regardless of the legal status or mission of an MFI. Comparing to ROE, the use of ROA takes into account the risks derived from the leverage and is the key bank profitability ratio (Althanasoglou et al, 2005). In this chapter, following some previous studies and recommendation by Microfinance Financial Reporting Standard, ROA was chosen as a proxy for profitability to measure the financial performance of MFIs. The ROA reflects the ability of MFI's management to generate profits from the MFI's assets. It shows the profits earned per unit of assets and indicates how effectively the MFIs assets are managed to generate revenues. This indicator is also the most common measure of profitability in bank or in other financial institutions. (see Abate, 2012, Sima, 2013).

Return on Asset = Net profits/Average Total Asset

Return on Equity= Net profit/Average Total Equity.

MFIs financial performance could be affected by a number of determining factors. In most literature, MFIs profitability is expressed as a function of internal and external determinants. Muriu(2011) also points out that the determinants of MFIs profitability can be divided into two main categories, namely the internal determinants which are management controllable, and the external determinants, which are beyond the control of management. The internal determinants of MFIs financial performance are those management controllable factors which account for the inter-firm differences in profitability, given the external environment. In this chapter, to test the effect of some determinants of financial performance of MFIs in Vietnam, factors were

extracted from different studies, namely on capital asset ratio, portfolio quality, gearing ratio or debt to equity ratio, size, GDP and inflation rate.

Portfolio Quality: For microfinance institutions, whose loans are typically not backed by bankable collaterals, the quality of the portfolio is absolutely crucial. Portfolio indicates the total funds available for the MFI to use as loans to its clients. Portfolio quality is a measure of how well or how best the institution is able to protect its portfolio against all forms of risks. Changes in credit risk may reflect in the health of MFI's loan portfolio which may affect the performance of the institution. When MFIs are faced with poor portfolio quality, they may write off the loans from their books or refinance the loans by extending the term, changing the payment schedule, or both. Theory suggests that increased exposure to credit risk is normally associated with a decrease of firm profits Consistent with the theory, Miller and Noulas (1997) postulate that the higher the risk exposure or the higher the accumulation of outstanding loans and the lower the profitability. We thus expect that loan at risk is negatively correlated with MFIs financial performance. Portfolio quality is often measured through credit risk. which can be proxied by the loan loss provision to loans ratio. In this study, it was calculated as the accumulation of past loan due 30 days or more (PAR >30 days).

Capital asset Ratio: The capital to assets ratio is a simple measure of the solvency of MFIs. This ratio helps an MFI assess its ability to meet its obligations and absorb unexpected loss. Expected losses should generally be covered through provisioning by the MFI's accounting policies, which removes expected losses from both assets and equity. Thus, the ratio measures the amount of capital required to cover additional unexpected losses to ensure that the MFI is well

capitalized for potential shocks. The ratio of total equity to total asset show us the capital strength of the microfinance institutions. The cost of insurance against bankruptcy might be high for a MFI with a low capital-asset ratio. It means that MFI with higher capital to asset ratios are considered relatively safer than one with lower ratios. Therefore, we expect significant positive effect from the equity to asset ratio on MFI's profitability. This argument is also similar to the conclusion reached by Athanasoglou et al (2006,2008); Muriu (2010)..

Gearing Ratio / Debt to Equity Ratio: The debt to equity ratio is calculated by dividing total liability by total shareholder's equity. The debt to equity ratio is a common measure used to assess a firm's leverage. According to Muriu 2011: the significant correlation between performance and gearing ratio is an indication that more debt relative to equity is used to finance microfinance activities, on one hand, and that long-term borrowings affect positively profitability by accelerating MFIs growth than it would have been without debt financing, on the other hand. Therefore, it is expected that adequate level liquidity is positively related with MFI's profitability.

Portfolio Management: According to existing literature, there is a relationship between bank's profitability and loan portfolio. It is expected that the growth of loan portfolio will lead to the increase of its profitability, taking into account the risk-return trade-off. Despite the higher operating cost of holding a large portfolio of loans, bank's profitability should increase with a higher ratio of loans to asset as long as interest rates on loans are liberalized and the bank applies a markup pricing. For microfinance institutions, one of the main important goals is providing loans to poor clients to help them eliminate poverty. Thus, like traditional banks. loans are among the highest yielding assets an MFI can add to its balance sheet and they provide

the largest portion of operating revenue. In this respect, unlike banks, MFIs in Vietnam require very a small voluntary deposit from their clients, they have to face high credit risk. In a bid to survive and maintain adequate profit level in the high competitive environment, MFIs trend to take excessive risks. The higher volume of loans supplied, the higher the interest income and hence the profit potential for MFIs. However, together with extending the volume of loan products to clients, some MFIs also choose to diversify their investment by depositing their funds in other banks… In this chapter we test the hypothesis: There is a positive relationship between the relative percentage of loans in the assets and profitability of a MFI.

Efficiency Management: MFI's efficiency is better measured by the operating expense ratio because it shows us how well MFIs is streamlining its operations and take in to account the cost of the input and/or the price of the output. The total MFI cost (net of interest payment) can be split into operating expense and other expense such as taxes, depreciation…but only operating expense can be considered as the direct outcome of MFI management. The efficiency of expense management can be calculated by dividing total operating expense to gross loan portfolio. This ratio measures the institutional cost of delivering loan services. The lower the operating expense ratio the higher the efficiency of an institution. This ratio is affected by portfolio size, loan size, staff salaries costs and credit methodology. Empirical studies also point that microfinance is costly business perhaps due to high transaction costs and information costs (Gonzaler, 2007 and Muriu 2011). Inefficiency in management fund can significantly decrease MFI's profitability (Muriu 2011). Thus, in our test, this ratio is expected to be negatively related to return on asset.,

Size of Microfinance (Total Asset): the profitability of a MFI may also be affected by its size. Large MFIs have larger capital can benefit more from scale and scope economies, and they can

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reach a relatively bigger number of clients than small one. The size of a MFI is measured by the value of its assets (Bogan et al 2007; Hermes et al,2008). According to Cull et al, (2007) the size of a MFI is significantly positively linked to its financial performance. Therefore, this variable is included to capture the economies or diseconomies of scale. Generally, the effect of a growing size on profitability has been proved to be positive to a certain extent. However, beyond that level, financial organization becomes too complex to manage and diseconomies of scale arise. Therefore, "size-profitability relationship could be expected to be non-linear" (Athanasoglou et al 2008).   To capture the relationship between MFIs size and profitability while also accounting for potential non-linearity, we use natural logarithm of total assets of MFIs as a proxy of size.

Regulation of Microfinance Institutions: According to CGAP, regulation of microfinance institutions is a set of government rules that apply to microfinance. They are meant to protect MFIs' clients, bring about fair play in the microfinance business, thereby enabling environment for the operation, development and growth of the microfinance industry. The move towards regulating microfinance institutions will enable MFIs to increase their funding from collected deposits and borrowing from the capital market. Bogan et al 2007 assert that unregulated microfinance institutions have limited option of capital source. This means that the regulation of microfinance may increase MFIs loanable funds and profitability.   However, literature also showes that regulations sometime restrict the development of the   microfinance institutions by setting a regulated interest-rate, making microfinance institutions unable to cover their cost. MFIs may become unprofitable due to the interest ceiling below the required interest rates that MFI need to break-even (Adongo and Stork 2006, Namibia case).   In this study, we will examine whether or not regulation status makes a different in terms of profitability by including

a dummy variable for regulation into the model. The dummy variable will be one if the tested microfinance institutions are regulated, and will be zero otherwise

Macroeconomic Variable (External Factor)

Real GDP: real GDP growth is used as a proxy of the macroeconomic environment. Arguably, this is the most informative single indicator of progress in economic development. Poor economic conditions can worsen the quality of the loan portfolio, thereby reducing profitability. In contrast, an improvement in economic conditions has positive effect on the profitability of MFIs, (Muriu, 2011). Thus, the variable is expected to exhibit a positive relationship with MFIs profitability.

Inflation rate: Microfinance institutions always operate in economic changing -environment. Macroeconomic variables such as inflation rates are likely to affect the financial performance of MFI. According to Revell 1979, the extent to which inflation affects financial institution's profitability will largely depend on whether inflation expectations are anticipated. When inflation is fully anticipated the financial intermediary can appropriately adjust interest rate in order to increase its revenues faster than the costs and realize higher profits. Conversely, if the interest rate isn't adjusted fast enough to inflation rate, increase in cost may be greater than in revenue, causing negative impact on profitability. To measure inflation rate, we use a measure of price changes in consumer goods and services (Consumer price index)

Table 23 : Variable description

S/N	Variable standard name	Description	Variable name in regression model	Expected effect
	MFI-specific Factors			
1	Capital asset ratio	Equity/Total asset	CAP	+
2	Portfolio Quality (%)	Outstanding balance, loan overdue>30 days/ gross loan portfolio	PAR	-
3	Gearing Ratio	Debt /Equity	GR	+
4	Operating Expense Ratio	Operating Expense/ Gross Loan Portfolio	OEP	-
4	Gross Loan portfolio to asset	Outstanding loan/Total Asset	OLA	+
5	Size of MFI	Natural logarithm of the total asset	SIZE	+
6	Regulation	Dummy Variable		+/-

	Macroeconomic Factors			
7	Economic growth	Real GDP growth (%)	GDP	+
8	Inflation	Rate (%)	IFL	--

5.5   SOURCE OF DATA AND REGRESSION MODELS

The study is based on data collected from annual report, financial reports of the respective MFIs and primary data. In this chapter, the study sample include members of People Credit Fund System, some other micro financial institutions including NGOs and others which registered in MIX, having 5- year data with 3 -star quality. We exclude Bank of Social and Policy because of it special characteristics of that bank. Member branches of VBARD who take part into micro financial business are also been put out of the dataset neither because of their secret financial policy so we cannot have enough necessary data in 5 years. As seen in Chapter 2, People's Credit Fund System (PCFs) with the financial cooperative model has demonstrated its success in reaching out rural and low-income customers while keeping its operational and financial sustainability (World Bank, 2007; Ozaki, M and H. D Seibel, 2008). PCF system includes Central People's Credit Fund - the apex institution, and 1200 individual inter-comune level PCFs. However, individual PCFs work independently and not all PCFs are good. Many PCFs work very sustainably, while few others are in bad conditions (Ozaki, M and H. D Seibel, 2008; ADB, 2010. In 2013, People Credit Fund changed into Co-opbank with 36 branches which categorized by 1200 credit funds member. Branches of Co-opbank in fact take responsibility as financial head clues of individual credit fund, direct their operations. Data for this research was data of 36 branches provided by the head office of PCFs (Cooperative Bank) with the collection of financial data of individual member-base credit funds. annual reports, and related researches; financial data of other NGOs and other microfinance institutions are collected from Government Center Banks, as well as their annual report, recalculation from converted data. All are used to

analyze for the periods of 5 years from 2010. External-specific variables were taken from the world development indicator (WDI) from world bank

Conceptual Model.

This study investigates the effect of internal and external factors on MFIs' profitability in a multi-variable and single equation. Linear functional forms without any test thanks to the widely- used evidences and good results in literature (Athanasoglou et al 2006, 2008; Muriu 2011…).

The conceptual or general panel data regression model postulated is:

$$Y_{it} = \alpha + \sum_{k=1}^{K} \beta_k X_{it}^k + \varepsilon_{it}$$

$\varepsilon_{it} = v_i + u_{it}$

In which Y_{it} is the value of dependent variable (measure of MFIs' profitability) of cross-section MFI_i at time t, where i= 1…n and t=1…T; α is a regression constant. β measures coefficient to be estimated. X_{it} represent k explanatory variables and ε_{it} is the error term with v_i is unobserved MFI-specific effects and u_{it} the idiosyncratic error. This is one-way error component regression model where $v_i \sim IIN\ (0, \sigma^2_v)$ and independent of $u_{it}\ (0, \sigma^2_u)$

Model Specification

Static model

In the assumption when markets are in equilibrium, in order to identify causal relationships between variables, static analytical framework is relevant with the following model:

$Y_{it} = \alpha + \sum_{n=1}^{N} \beta_n X_{it}^n + \sum_{m=1}^{M} \beta_m X_{it}^m + \varepsilon_{it}$

$\varepsilon_{it} = v_i + u_{it}$

in which: X_{it}^{n} presents for MFI-individual industrial characteristics; X_{it}^{m} are macroeconomic factors, ε_{it} is disturbance in which v_i is unobserved individual-specific effect; and u_{it} is the idiosyncratic error.

Dynamic model: There is no certainty that conduct or performance measures observed at any point in time represent equilibrium value. Like bank, MFI's profits show a tendency to persist over time (Muriu 2011) reflecting impediment to market competition, informational opacity and/or sensitivity to the macroeconomic shocks to the extent that these are serially correlated (Berger et al 2000, Athanasoglou et al 2008). It is also reported in literature that there is a positive and statistically significant relationship between the lagged profitability and profitability implying profit might be determined by the previous period. Therefore, rather than the standard static linear regression model which is relevant when identifying causal relationships between variables when markets are in equilibrium, we use a dynamic model by including a lagged dependent variable among regressors.

$$Y_{it} = \alpha + \delta Y_{i,t-1} + \sum_{n=1}^{N} \beta_n \ X_{it}^{n} + \sum_{m=1}^{M} \beta_m \ X_{it}^{m} + \varepsilon_{it}$$

$Y_{i,t-1}$: one-period lagged profitability and δ is the speed of adjustment to equilibrium

Specific models:

In this study, we use "return on asset" (ROA) to capture the profitability of MFIs in Vietnam. The explanatory variables X_{it} are grouped into MFI-specific, industry-specific and macroeconomic variables. Amidst several indicators available for each component, capital asset ratio and leverage ratio, total outstanding loan to asset, portfolio at risk are chosen to represent MFIs' management of asset and loan portfolio quality, size, legal status are proxies for industrial specifics and GDP and inflation ratio are macroeconomic factors.

$ROA_{it} = \alpha + \beta_1 * CAP_{it} + \beta_2 * OLA_{it} + \beta_3 * GR_{it} + \beta4 * PARit_+ \beta_5 * SIZE_{it} + \beta_5 * OEP_{ij} + \beta_6 * REG + \beta_7 * GDP_{it} + \beta_8 * IFL_{it} + \varepsilon_{it}$ (static model)

$ROA_{it} = \alpha + \delta ROA_{i,t-1+} \beta_1 * CAP_{it} + \beta_2 * OLA_{it} + \beta_3 * GR_{it} + \beta4 * PARit_+ \beta_5 * SIZE_{it} + \beta_5 * OEP_{ij} + \beta_6 * REG + \beta_7 * GDP_{it} + \beta_8 * IFL_{it} + \varepsilon_{it}$ (dynamic model)

Where β_1 to β_8 are the coefficients of the variables

α; stands for the intercept term

$CAP_{it:}$ stands for Capital asset ratio for MFIi at time t

PARit: stands for portfolio quality for MFIi at time t

GRit: stands for gearing ratio or debt/equity ratio for MFIi at time t

OLAit stands for Total Performing Loan/ Total Asset for MFIi at time t

OEP_{it} stands for Operating Expense/Gross Loan Portfolio for MFIi at time tSIZEit: stands for size of micro finance for MFI i at time t

REG is dummy variable showing legal status of MFI in Vietnam

REG=0 if MFI is not regulated and REG=1 otherwise.

GDPit: stands for growth domestic product of the country

INFit: stands for inflation rate for MFIi at time t

We add time effects in the error component of the model to capture some developments if any that could take place in Vietnam's microfinance industry during the study period. Thus, error term is turned into

$\varepsilon_{it} = v_i + \Lambda_t + u_{it}$

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in which ε_{it} is disturbance in which v_i is unobserved individual-specific effect; Λ_t is unobserved time effects and u_{it} is the idiosyncratic error. We will test the joint significance of the unobservable time effects with the H_o hypothesis as follows:

H_o: $\Lambda_2 = \Lambda_3 = \ldots = \Lambda_T = 0$

The Lagrange Multiplier (LM) test result shows that with the $\chi^2(4) = 10.48$ and the Prob $= 0.0368 < 0.05$ then we reject Ho, time specific dummy variable is significant, thus we will estimate the model adding year-specific dummy variables to control Λ_T. We experimented with many dummies and the only significant coefficient is that of the 2011 dummy. We expand the model with time effect as follows:

$ROA_{it} = \alpha + \beta_1 *CAP_{it} + \beta_2 *OLA_{it} + \beta_3 *GR_{it} + \beta4*PARit_+ \beta_5*SIZE_{it} + \beta_6*OEP_{ij} + \beta_7*REG + \beta_8 *GDP_{it} + \beta_9*IFL_{it} + \Lambda Y1_+ \varepsilon_{it}$ (static model)

$ROA_{it} = \alpha + \delta ROA_{i,t-1+} \beta_1 *CAP_{it} + \beta_2 *OLA_{it} + \beta_3 *GR_{it} + \beta4*PARit_+ \beta_5*SIZE_{it} + \beta_6*OEP_{ij} + \beta_7*REG + \beta_8 *GDP_{it} + \beta_9*IFL_{it} + \Lambda Y1 + \varepsilon_{it}$ (dynamic model)

In which $\varepsilon_{it} = v_i + u_{it}$;

Y1 is dummy variable for the year 2011

5.6   DATA DESCRIPTION

In this part, we will present summary statistic for all dependent and independent variables using the pooled data set over the period 2010-2014.

Dependent Variable

In this study, return on Asset (ROA) ranged from the minimum value of -0.4182 to maximum of 0.1472. It is a ratio of microfinance income to their total asset. The ROA reflects the ability of MFI's management to generate profits from the MFI's assets. It shows the profits earned per USD of assets and indicates how effectively the MFIs assets are managed to generate revenues. MFI includes in the sample of this study period was indicated the average positive value of 02 cents in everyone USD investment they made on the total asset and the profitable MFIs earn 0.14 cent of profit after tax for a single USD investment they made on total asset. On contrary, net profit MFIs lost 0.41 cent of everyone USD investment they made on total assets of the firm. This clearly illustrates the disparity of rates of return earned by MFIs.

Independent variables

Regarding the variable Par>30, the higher its value, the riskier the credit portfolio, which can have a negative influence on the financial performance of the MFI because it is an indication of poor repayment rate. For this study case, the mean of the par is 1.23% and the maximum is 9.09% and minimum is 0 % respectively. Any portfolio at risk (par > 30 days) exceeding 10 % should be a serious cause for concern; because unlike loans of commercial banks, most loans are not backed by bankable collateral. Therefore, the result of the study shows that during the study period, the portion of the portfolio in arrears or

unpaid is 1.23% on average, which is quite good, but the maximum 9.09% result implies that the credit portfolio of some MFIs in the sample is highly risky.

In relation to the Capital to asset ratio variable, there was much deviation in capital to asset ratio of selected MFIs with mean value of 21.36% the range from 3.57% to 83.4%; the standard deviation of 19.24%. This ratio is a simple measure of the solvency of regulated and unregulated MFIs, which helps to assess the ability of MFI to meet its obligations and absorb unexpected losses. It is suggested that an initial capital-asset ratio be no lower than about 20% for MFIs, subject to downward adjustment as the institution and the industry gain experience[43]. Indeed, there are strong arguments against allowing MFIs to leverage their equity capital (borrow a greater proportion of funds) as aggressively as commercial bank. Thus, CGAP advised that MFIs should be subject to maintain or even higher the above suggested ratio to safeguard their portfolio. In our study, the capital to asset mean value could be above the standard requirement of capital adequacy ratio partly because of the fact that greater part of the sample Vietnamese MFIs' assets is funded with donor contributions that are generally considered capital. The maximum capital asset ratio value estimate suggested that about 83.14% of the total assets of some MFIs in the sample were financed by shareholders' funds while the remaining was financed by deposit liabilities. However, the ratios also showed us week borrowing capability of the sample MFIs to leverage their fund. In long term, it could be a concern because donor funding source is not stable and it could decrease by the time.

The gearing ratio or the Debt to equity ratio is another ratio for the capital adequacy of MFIs because it measures the overall leverage of the institution. This ratio is of interest to lenders because it indicates the extent to which an MFI has leveraged its own funds to

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[43] Microfinance handbook: An institutional and financial perspective-Joanna Legerwood 1999,

finance its portfolio and other assets. In the study period, we found that the average value of 1.30 and maximum value of 13.38 and 0 minimum value. The ratio indicates that on the average, Vietnamese MFIs is still lower leverage in comparison with average ratio of 5.2 in South Asia region and world average rate of 4.3[44]. As said above, week borrowing capability could be one of disadvantage for MFI's operation in long term and it needs to be concerned because MFIs should be financial sustainable and independent from donor funding source.

The MFIs size plays an important role to maintain the position of a MFI in the market. The mean value of the variable is 14.79 in its natural logarithm value, whereas the maximum and minimum values are 19.09 and 11.76 respectively. The average efficiency of sample MFIs was 10.29%, the maximum was 14%. Indeed, the average efficiency of sample MFIs was low in comparison with that ratio of 23% in region but it is just average proxy ratio that take from report of VMFVG basing on scale of loan portfolio so they couldn't reflect all the operating expenses in reality.

In general, although almost Vietnamese MFIs has high ratio of gross loan portfolio (84.29% in average) they can control risk quite well with low loan delinquency rate in average and not high operating expense. However, greater proportion of funding sources comes from shareholders or Government donor funds with low interest, voluntary saving amount still limited and not enough for funding lending activities This fact will be appear later to be one of problems for business performance, as MFIs try to be self-sufficient without donors.

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[44] Data from Performance Indicators for Microfinance Institution-Microrate 2003

Table: Data Description

Variable	Obs	Mean	Std. Dev.	Min	Max
roa	190	.0216463	.0539468	-.4182	.1472
ola	190	.8429506	.0955514	.291724	.9863
oep	190	.1029589	.0200675	.0424	.14
par	190	1.227455	1.559714	0	9.09
gr1	190	1.305892	1.402408	0	13.3
cap1	190	.2135811	.1923795	.0357053	.8314
size	190	14.79514	1.589331	11.7614	19.0983
gdp	190	.0584	.0046426	.052	.064
inflationcpi	190	.0912	.0506127	.041	.187
Regulated	190	.8157895	.38868	0	1

Correlation analysis

Multiple correlation is a measure of the degree of association between dependent and all the independent (explanatory variables) jointly (Gujirati, 2004). The analysis was meant to indicate whether variables were correlated or not. In correlation analysis, we estimate a sample correlation coefficient, more specifically the Pearson Product Moment Correlation Coefficient. The value of correlation coefficient ranges between -1 and +1. Closer to 1 means strong correlation and a negative value indicates an inverse relationship (when one goes up the other goes down). The correlation coefficient of 0 indicates that there is no linear relationship between the two variables. If variables are not correlated, then using several simple regressions or one multiple regression models could give the same results (Dougherty 2006 as cited Yonas, 2012). The main aim of conducting correlation is to investigate whether there is a perfect linear combination among variable. The result showed us that variable is correlated; consequently, one multiple regression is more suitable than several simple regressions due to the fact that with several simple regressions,

we couldn't measure the partial effect of individual variables. The level of correlation is very low so we can rule out any problem of multicollinearity which reduces the efficiency of the estimates. According to Gujarati, (2004) multicollinearity could only be a problem if the correlation coefficients among regressors are above 0.80. According to Hailer et al, (2006) cited in Birhanu, (2012) multicollinearity could only be a problem if the correlation coefficient among regressors are above 0.90 which is not the case of the variables in this study. In addition, to test more about the possibility of multicollinearity problems, we computed the variance inflation factor (VIF) for each coefficient to test. If a vif >10 or 1/vif <0.10 indicates troubles. The result of the test shows that the VIF is 1.55 within the threshold of non-existence of multicollinearity.

	roa	ola	par	oep	gr1	cap1	size	gdp	inflat~i	Regula~d
roa	1.0000									
ola	0.2200	1.0000								
par	-0.2762	-0.1857	1.0000							
oep	0.0245	0.1824	0.1126	1.0000						
gr1	-0.1471	0.0941	0.0418	-0.0048	1.0000					
cap1	0.4101	0.3191	-0.0147	0.2509	-0.3042	1.0000				
size	0.1252	-0.0110	-0.2641	-0.0710	0.1452	-0.2366	1.0000			
gdp	-0.0952	0.1407	-0.3542	0.2880	-0.1677	0.0700	0.3185	1.0000		
inflationcpi	-0.0362	0.1542	-0.0454	0.0771	-0.3030	-0.0926	-0.2598	0.2256	1.0000	
Regulated	-0.0774	-0.3357	-0.0156	-0.1649	0.1801	-0.6126	0.1340	0.0000	0.0000	1.0000

Variable	VIF	1/VIF
cap1	2.19	0.455872
Regulated	1.69	0.592834
gdp	1.64	0.610918
inflationcpi	1.54	0.650033
size	1.52	0.659642
gr1	1.43	0.700626
ola	1.40	0.715454
par	1.29	0.775526
oep	1.28	0.781277
Mean VIF	1.55	

Before running the regression, we conducted some test to check some necessary assumptions for multiple regression.

Test for serial correlation in error term. In multiple variable regression, it is assumed that the covariance between the error terms is zero that means the errors are uncorrelated with one another. If the assumption is not hold, errors are auto-correlated and causes the standard errors of the coefficients to be smaller than they actually are and the R-squared to be higher. For this kind of test, we use Wooldridge test. The test result showed that p-value > 0.0421 showing that there is no presence of serial correlation

```
Wooldridge test for autocorrelation in panel data
H0: no first-order autocorrelation
    F(  1,      37) =      4.434
           Prob > F =      0.0421
```

Test for existence of heteroscedasticity: it is hard to assume homoscedasticity in the model because most of exogenous variables are time variant across MFIs so error may not have a constant variance. We used Breusch-Pagan test to test the null hypothesis that there is constant variance across the range of explanatory. The p-value of the test statistic is statistically significant and $\chi^2(9) = 605.89$ showing that we can soundly reject the null hypothesis. In the case of heteroskedastic errors, OLS estimators will still give unbiased and also coefficient estimates but they are no longer BLUE- that is no longer have the minimum variance among the class of unbiased estimators. The reason is that errors variance appears in the formulae to compute coefficient variance, so when they are heteroskedastic, the coefficient standard errors could be wrong and hence any inferences made from estimates could be misleading. To deal with heteroscedasticity, we use robust standard error. Stata includes options with most routines for estimating robust standard error. Heteroskedasticity causes standard errors to be biased. OLS assumes that errors are both independent and identically distributed, robust standard errors relax

either or both of those assumptions. Hence, when heteroskedasticity is present, robust standard errors tend to be more trustworthy. With Stata, robust standard error can usually be computed via the addition of two parameters robust and cluster.

```
Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
        Ho: Constant variance
        Variables: ola par oep gr1 cap1 size gdp inflationcpi Regulated

        chi2(9)      =   605.89
        Prob > chi2  =    0.0000
```

-**Test for Random Effect versus Fixed Effect Model**: Like many other previous studies about determinants of MFI's profitability, our experiment research has to cope with two problems: omitted variables and the endogeneity problem. Omitted variable bias occurs when some important variables were not included in the models but affect the dependent variable significantly. According to Ganka Daniel Nyamsogoro (2010) and Hsiao (2007), in order to deal with omitted variables, we need to know the nature of omitted variables: time specific and/or individual specific omitted variables. The endogeneity problem occurs when an explanatory variable is correlated with the error term. Endogeneity can arise as a result of measurement error, auto regression with auto-correlated errors, simultaneity and omitted variables. To deal with this kind of problems, it is necessary to use a panel methodology because it helps taking into consideration the potential endogeneity of the regressors, while at the same time controlling for firm-specific effects, increasing the sample size and degree of freedom. In our case, there is a correlation between the MFI and/or time effects and the exogenous variable. The solution for dealing with the endogeneity problem is the MFIs and the time effects should be estimated as dummy variables. With panel data, estimation bias is lower than with either time-series or cross-sectional data estimation. However, if we conducted a regression analysis on the panel data using OLS method, it would

have risen the heterogeneity bias because we would have ignored the differences between MFIs. Therefore, instead of OLS, we could use more appropriately least square fixed effect or random effect models, as suggested and used in previous studies.

Fixed effect model examines that the individual differences in intercepts, assuming the same slope and constant variance across individual. Since an individual specific effect is time invariant and considered as a part of the intercept, unobserved individual effects can be allowed to be correlated with other regressors. Thus, the changes in variables over time (as a result of unobservable effect of omitted variable) can be used to estimate the effect of independent variables on the dependent variable. Fixed effect model is suitable if we want to control for the omitted variables that differ across MFI but are constant over time.

Random effect model assumes that individual effects are not correlated with any regressor and then estimates error variance specific to groups (or times). Therefore, the individual specific random effects are component of the composite error term. The intercept, and slopes of regressors are the same across individual. The difference among individuals (or time periods) lies in their individual specific errors, not in their intercept. It is appropriate when the sample is believed to be randomly selected and to be representative of the population.

The choice between fixed effects model or random effects model can be done through the Hausman specification test. If the null hypothesis that the individual effects are uncorrelated with the other regressors is not rejected, a random model is favored over its fixed counterparts. First, we estimated the fixed effects model, save the coefficient, second, we did the same with random effects models and then compared the two results with each other through Hausman test value which is larger than the critical chi-square, then the fixed estimator is the appropriate choice. The Hausman test statistic is $\chi^2(10)= 8.68$ and p-value $>\chi^2= 0.5623$ but warned (V_b-V_B is not positive definite). This means that the test is not conclusive, Hausman statistic may not have

resulted in the best possible value. Reasons for that are homoscedasticity and positive definite

differences of variance are among the main assumptions of the Haussman test and maybe the scale

of at least one of the coefficients is incompatible with running this test (in our case, we can see the

coefficient of gr1 negative and very small). Therefore, in order to make sure of selecting the best

model, we conducted Mundlak test to alternative to Haussman test. Unlike Haussman test,

Mundlak approach could be used when errors are heteroskedastic or have intragroup correlation.

Under the Mundlak test, we will test that the panel-level mean of time-varying covariates are

jointly zero. If the coefficients are jointly zero, it means there is correlation between the time-

invariant unobserved variables and regressors. Then the fixed-effects assumptions are satisfied.

Otherwise, random effect model will give the consistent result. The results showed that χ^2

$(6)=6.24$ and p-value $>\chi^2=0.3967,$ evidenced that we are wrong to reject the null hypothesis.

Thus, the RE model would be appropriate.

	──── Coefficients ────			
	(b)	(B)	(b-B)	sqrt(diag(V_b-V_B))
	fixed_group	random_group	Difference	S.E.
ola	.0547725	.0625332	-.0077607	.0145526
oep	.3118275	.3101012	.0017263	.0156436
par	-.0056965	-.0065857	.0008892	.0004957
gr1	-.0019917	-.0018983	-.0000934	.0007339
cap1	.1060323	.1417516	-.0357194	.0209576
size	.0119241	.0125191	-.000595	.0010972
gdp	-5.276731	-5.580095	.3033635	.2079578
inflationcpi	-.4634267	-.35409	-.1093368	.0743909
year				
2011	.0822583	.0705098	.0117485	.0094969
2012	.0064493	.0041174	.002332	.0023006

```
                    b = consistent under Ho and Ha; obtained from xtreg
         B = inconsistent under Ha, efficient under Ho; obtained from xtreg

   Test:  Ho:  difference in coefficients not systematic

              chi2(10) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                      =        8.68
           Prob>chi2 =      0.5623
           (V_b-V_B is not positive definite)



. estimate store mundlak

. test mean_par mean_gr1 mean_cap1 mean_size mean_gdp mean_inflation mean_ola mean_oep

 ( 1)  mean_par = 0
 ( 2)  mean_gr1 = 0
 ( 3)  mean_cap1 = 0
 ( 4)  mean_size = 0
 ( 5)  o.mean_gdp = 0
 ( 6)  o.mean_inflationcpi = 0
 ( 7)  mean_ola = 0
 ( 8)  mean_oep = 0
      Constraint 5 dropped
      Constraint 6 dropped

        chi2(  6) =    6.24
      Prob > chi2 =    0.3967
```

-**Test Random Effect versus Pooled OLS Model:** We further checked for the appropriateness of

using RE model as opposed to pooled OLS. We applied the Breusch and Pagan Lagrangian

multiplier test for random effects. We test the null hypothesis that there were no random effects and thus, the pooled OLS was appropriate. The result shows that the p-value of the test statistic to be statistically significant. We reject the null hypothesis to indicate the existence of random effects. Thus, we confirm that RE model is suitable.

```
Breusch and Pagan Lagrangian multiplier test for random effects

        roa[code1,t] = Xb + u[code1] + e[code1,t]

    Estimated results:
                            Var      sd = sqrt(Var)

              roa |    .0029103       .0539468
                e |    .0007026       .0265067
                u |    .0010459        .032341

    Test:   Var(u) = 0
                          chibar2(01) =   112.91
                        Prob > chibar2 =   0.0000
```

The static random-effect panel model gives us a snapshot of all effects on the dependent variable from changes in the explanatory variables which are selected within the same period as the change occurs. In other words, in a static analysis, we ignore the passage of time, and we seek to establish the causal relationship between certain variables relating to the same point in time, assuming some determining factors as remaining constant. Dynamic analyzing method is more realistic by taking account changes in the explanatory variables through times. Dynamic models include lagged values of the dependent variable as an explanatory variable in the regression equation, together with lagged values of the explanatory variables. When estimating a dynamic equation, we are likely to encounter several econometric problems:

+Endogeneity: The possibility of reverse causation from profitability to capital, liquidity structure may result in simultaneous-equation, therefore, the independent variable may be correlated with the error term.

+The presence of the lagged dependent variable gives rise to autocorrelation

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+The panel data set has a short time dimension.

All these problems make standard fixed effect estimators inconsistent. As indicated by Baltagi (2011), least squares estimation methodology produces biased and inconsistent when the nature of model is dynamic. In order to deal with endogeneity, standard econometric method suggests using relevant external instruments that are uncorrelated with the error term. However, it is not easy to find out valid instruments that can fulfill all necessary conditions. Therefore, more advanced dynamic panel data estimators are required to estimate consistent elasticities. General Method of Moment (GMM method) is our good solution because its methodology allows us to use the set of instruments contained within the data itself but still not limit to the external instruments if any. Moreover, it helps to test the impact overtime as well as it reduces the bias that results from heterogeneity. There are two main available estimators to use in the case of large N, small T datasets: Arrellano & Bond and Blundell & Bond. We have to determine which of these estimation technique is suitable. The Blundell-Bond estimator requires more assumptions than the first one but is more efficient and still consistent when the data is highly dependent on previous periods.

Arrelano &Bond suggest an estimator constructed to deal with the endogenous nature of the lagged dependent variable. That is Difference Generalised Method of Moments (GMM) estimator, which uses estimates of the sample mean, variance… to estimate the parameters of interest. This approach is broadly similar to standard instrumental variable estimators with different variables being used as instruments for the lagged dependent variable. In order to use this estimator, it is necessary to meet the requirement that there should be no serial correlation in the idiosyncratic errors and the explanatory variables are weakly exogenous otherwise the instrumentation is not valid and hence the estimator is inconsistent. If the time series is close to contain a unit root, Arellano-Bond estimator can perform poorly. With a fixed number of years panel and a substantial

number of observations, Arrellano and Bond suggests estimating equation with GMM based on first-differences by first differencing the initial equation. The instruments include all available lags of the dependent variable plus lag of the other explanatory variable. But the Arellano and Bond estimator has been criticized when applied to panels with very small T, instruments are weak

Blundell & Bond propose a system of equation/GMM estimator that accounts for this problem. System-GMM is derived from the estimation of a system of two simultaneous equations, one in level (with lagged first differences as instruments) and the other in the first differences (with lagged levels as instruments). Under Blundell-Bond estimators it is assumed that the initial observations must have a very small impact on the observed observations.

We are also confronted with the choice of using one-step or two-step estimation. The one-step estimator assumes homoscedastic errors while the two-step estimator uses the first step errors to construct heteroscedasticity consistent standard errors, relaxing the assumption of homoscedasticity and more relevant when explanatory variable includes time invariant variable. Therefore, two steps estimator is asymptotically effective.

In this study, we chose the two steps - GMM method because it is more efficient and presents theoretical advantages over the Arrellano-Bond estimator. It was developed to estimate models using data where the autoregressive coefficient is close to one (ie: data is strongly determined by value in the previous period.). To check the model specification validity, we calculate the Hansen test of over identification of restrictions, this test examines the lack of correlation between instruments and error term. We also implement an autocorrelation test by checking the existence of first-degree and second-degree autocorrelation as model should not have second order autocorrelation. To account for the small sample bias, we use robust small sample corrected standard errors proposed by Windmeijer (2005)

5.8   DISCUSSION OF THE RESULTS

Regression analysis generates an estimated equation to describe the statistical relationship between predictor variables and the response variables. Now let's examine the output of the static regression. In this chapter, we estimate the same linear specification both with and without macroeconomic control variables and present the robust results of the empirical model as follows:

```
. esttab, r2 ar2 se scalar (rmse)
```

	(1) roa	(2) roa
ola	0.0513	0.0614
	(0.0353)	(0.0330)
oep	-0.0334	0.318**
	(0.127)	(0.123)
par	-0.00289	-0.00641***
	(0.00185)	(0.00176)
gr1	-0.0000760	-0.00193
	(0.00218)	(0.00215)
cap1	0.0926***	0.145***
	(0.0237)	(0.0264)
size	0.00235	0.0125***
	(0.00197)	(0.00240)
gdp		-5.718***
		(0.786)
inflationcpi		-0.295
		(0.170)
Regulated		0.0349*
		(0.0165)
Y1		0.0631**
		(0.0237)
_cons	-0.0690	0.0514
	(0.0413)	(0.0494)
N	190	190
R-sq		
adj. R-sq		
rmse	0.0308	0.0265

```
Standard errors in parentheses
* p<0.05, ** p<0.01, *** p<0.001
```

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R^2 value of model 2 which includes macroeconomic determinants is 0.4489 (44.89 %), which implies that approximately 45% of fitness can be observed in the sample regression line. This can be further explained as, 45% of the variability of ROA is explained by the independent variables (Capital to Asset ratio, portfolio Management, Operation Expense, Size, Inflation, GDP, gearing ratio, Regulation, and Portfolio at Risk>30 days) jointly. The remaining 55% of change is explained by other factors which are not included in the model. This value is relatively high enough to enhance the explanatory power of the regression model). The coefficients for each of the variables indicates the amount of change one could expect in ROA give a one-unit change in the value of the variable, given that all other variables in the model are held constant. The null hypothesis of F-statistic (the overall test of significance) that the R^2 is equal to zero was rejected at 1% as the p-value was sufficiently low. The F value is 0.000 which indicates strong statistical significance, which enhanced the reliability and validity of the model. Each variable and its significance are presented in detail under the following sections.

```
Random-effects GLS regression              Number of obs     =        190
Group variable: code1                      Number of groups  =         38

R-sq:                                      Obs per group:
    within  = 0.2997                                      min =          5
    between = 0.5216                                      avg =        5.0
    overall = 0.4489                                      max =          5

                                           Wald chi2(10)     =      93.37
corr(u_i, X)   = 0 (assumed)               Prob > chi2       =     0.0000
theta          = .65661204
```

roa	Coef.	Std. Err.	z	P>|z|	[95% Conf. Interval]	
ola	.0613612	.0330178	1.86	0.063	-.0033524	.1260748
oep	.3177707	.123139	2.58	0.010	.0764227	.5591188
par	-.006413	.0017595	-3.64	0.000	-.0098616	-.0029645
gr1	-.0019346	.0021463	-0.90	0.367	-.0061413	.0022722
cap1	.1445654	.0264134	5.47	0.000	.0927961	.1963348
size	.0125093	.0023958	5.22	0.000	.0078137	.017205
gdp	-5.717689	.7862318	-7.27	0.000	-7.258675	-4.176703
inflationcpi	-.2945848	.1696141	-1.74	0.082	-.6270222	.0378527
Regulated	.0348545	.0165375	2.11	0.035	.0024416	.0672674
Y1	.0630929	.0237113	2.66	0.008	.0166197	.1095662
_cons	.0513755	.0494041	1.04	0.298	-.0454547	.1482056

sigma_u	.03235056					
sigma_e	.02644823					
rho	.5993803	(fraction of variance due to u_i)				

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Interesting results appear in both significant and non-significant findings. Looking at the regression coefficients, we can see that: among the MFIs specific independent variables: operating expense management, loan delinquency rate>30 days, size, capital to asset, GDP, Regulated, year 2011 had a statistically significant impact on profitability whereas loan delinquency rate, capital to asset, size, GDP are the four variables affecting to ROA the most significant while there is no influence of gross loan portfolio, debt to equity, inflation.

Loan Portfolio to asset and **Operation Efficiency**

In the empirical literature, the ratio of loan portfolio to asset is used both as a measure of credit risk and lending specialization. Loan are less liquid and more risky than other assets in a MFIs' portfolio. MFI with a relatively high portfolio to asset ratio may be at greater risk of failure because more loans means that more risk of default and more additional costs incurred in managing credit risk. Operational efficiency which is measured by operating expenses divided by total assets is a performance ratio showing how well MFIs is streamlining its operations and taking into account the cost of the input and/or the price of output. In Vietnam, almost MFIs specialize in lending, they have high loan portfolio to asset ratio. Although high loan portfolio rate could be translated into high interest revenue, their loans are subject to significantly higher transaction costs including cost of fund for on-lending, loan loss and administration cost. Efficiency in management expenditure should ensure a more effective use of MFIs loanable resources, which may enhance MFIs' profitability. In our examination, the positive statistically significant of operating expense to total asset ratio at the level $p<0.01$ suggested thatexpense management is an important determinant of profitability for MFIs in Vietnam.

Portfolio quality

Portfolio quality is a measure of how well or how best the institution is able to protect total funds available for the MFIs against all forms of risks. Literature shows that wide exposure to credit

risk is generally related to low firm profitability. In our study, the coefficient of the portfolio-at-risk at > 30 days is negative, as expected and statistically significant at the level of 0.001. This confirms the hypothesis that a significant reduction in the portfolio-at-risk at > 30 days should have a positive impact on the MFI's financial performance. In other words, a high portfolio- at-risk would limit the revenue derived from microcredit operations and therefore decrease the amount of loanable funds. The negative value of the coefficient of -0.006 of the portfolio-at-risk clearly illustrates this problem. The portfolio at risk (PAR) shows how efficient an MFI is in making debts recovery. A high PAR implies low repayment rates, i.e., an indication of inefficient MFI, therefore, the less financial performance. The sign of this ratio is consistent with Muriu, (2011), Yonas, (2012), and is in line with the view that there is a negative relationship between quality of portfolio and profitability. The finding suggested that MFIs in Vietnam could expand profitability by screening and monitoring more efficiently credit risk and thus by improving the estimation of future risks. According to our results, MFIs should focus on credit risk management in order to improve credit risk evaluation

Capital to Asset ratio

Key to the ability of a microfinance institution to absorb unexpected losses is the ability to monitor capital adequacy and solvency ratios. Capital adequacy and solvency ratios determine the risk- taking behavior of MFIs. Literature shows us that there is significant negative effect of capital adequacy and solvency on the levels of non-performing loans. Well capitalized microfinance institutions tend to be less inclined to expand their performance especially in taking riskier loan activities, which will affect significantly to their returns and profitability. In other words, MFIs operated over-cautiously to avoid eating their regulatory capital, tend to ignorepotential profitable opportunities over the periods. It also implies that setting up high capital regulatory requirement may have a negative impact on MFIs' performance. However,

inadequate capitalization and liquidity will lead to inability to absorb severe shocks and ultimately, to collapse. Analysts suggest that minimum capital adequacy for MFIs should exceed the Basel II recommendations by at least 50%, i.e that MFIs should maintain capital adequacy ratio of 12% or higher[45].   In our case, we use capital ratio which was computed by using total equity/total asset as the proxy for the capital and solvency ratios. The coefficient of the capital to asset ratio (CAP) is (0.09266) This shows that for the study period 2009 up to 2014 capital strength of Vietnam MFIs had a positive relationship with their financial performance or holding constant all other variables. Therefore, hypothesis No.1, according to which financial performance hold a positive relationship with capital asset ratio of MFIs is supported by our estimates. This result is in line with the argument that well capitalized MFIs are more flexible in dealing with problems arising from unexpected losses and against credit risks and results in a better chance for financial performance. Moreover, the result is statistically significant and conclusive. Therefore, we confirm firmly about the perceptions of majority of MFIs branch managers that capital to asset ratio can have a significant impact on the financial performance of their MFI. This result is consistent with the conclusions of Muriu (2011) and other researchers like Athanasoglou et al (2008); Demirgue-Kunt and Huizinga (1999)...but contradict the view of Goddard et al (2010) who finds lower profitability for high capitalized banks in the traditional banking industry.

Size of MFI (Total Asset):

Natural logarithm of total asset of MFIs is used as a proxy for the size of MFIs. As with relative market power theory and scale efficiency theory, size of a firm expands its market power and its profits. The significant result for MFI size at the level of 0.001 confirms the economies of scale hypothesis in the microfinance intermediation process and shows the importance of MFIs' size

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[45] Meegan (2004), Estelle Berger (2010)-Addressing Capital Adequacy for MFIs: A risk management approach-page 5

affecting MFIs financial performance in Vietnam during the study period. The result is in line with hypothesis namely financial performance has positive relation with the size of MFIs in Vietnam, indicating that large MFIs in the industry have significantly enjoyed significant economies of scale. This result confirms Cull, Demirguc-Kunt and Morduch (2007), Muriu (2011) and also consistent with Merland and Strom (2009), Athanasoglou et al (2006). This result provides more evidence for the argument of Muriu (2011): failure to become profitable in microfinance is partly due to lack of scale economies. MFIs may have to institute a dual objective of profit maximization while jointly pursuing a managerial goal of firm size maximization.

Gearing ratio or Debt to Equity ratio

The debt to equity ratio is a common measure used to assess a firm's leverage, or in other words it shows us how much the MFI uses equity and debt to finance its assets. As the debt increases the financial leverage increases. Highly leveraged MFIs may perform better by enjoying scale economies, enhancing their ability to boost profitability, However, the excessive use of financial leverage can severely limit future cash flow and create a lot of risk and bankruptcy. Management tends to prefer equity financing over debt since it carries less risk. Unfortunately, equity financing is more expensive. Continually relying on equity financing will led to a loss of a certain amount of decision-making authority, a factor that could inhibit growth strategies just as much as a lack of funding. In practice, the various capital structure theories don't explain actual financing behaviors and experiment researches so far also have given many contrary results In our study, the ratio showed up a negative coefficient (-0.00186) and it is not statistically significant variable. This implies an insignificant relationship between financial performance and the gearing ratio for the study period especially with the inclusion of macroeconomic factors. MFI's profitability wasn't influenced by debt financing in Vietnam during our study period. Non-financed microfinance

institutions were concerned by the negative impact of long term borrowing on their profitability hence depend more on their internal source of financing. Their assets are mainly funded by equity rather than by borrowing from other sources. The result is not consistent with Muriu, (2011), according to whom an increase in debt relative to equity exerts a positive impact on MFIs financial performance. . But it has the same sign with the researches of Cassar and Holmes (2003) and Hall et al (2004) who found a negative association between profitability and both long-term debt and short-term debt ratios. The result supports the hypothesis, indicating gearing ratio has negative effects on financial performance of MFIs in Vietnam and consistent with branch managers' perception that the rise in the gearing ratio would not have a positive impact on the financial performance of their MFI.

GDP and Inflation.

Economic growth is among the most commonly used macroeconomic variable, as it is a measure of total economic activity within an economy. This study used real GDP growth as a proxy of the macroeconomic environment. Regarding to the inflation factor, we use the CPI rate as a proxy for Inflation rate. The consumer price index measures the annual percentage change in the cost to average consumer of acquiring a given basket of goods and services. The result shows that the both of GDP and inflation exert a negative effect on the profitability of MFIs in Vietnam. Reasons for inflation's negative impact could be that inflation was not anticipated MFIs' managers wouldn't adjust rates timely and overhead costs would rise quicker than inflation resulting in poor profits. This effect is statistically insignificant so that inflation is not one of important determinant of MFI's profitability. While the negative estimated coefficient of inflation supports the hypothesis that inflation rate is negatively associated with MFI's profitability, the negative effect of GDP is opposite with the expected sign. One can view GDP as measuring the size of the market in which MFIs operate. In upturn, there will be high demand for

credit than in downturn so expect MFIs' profitability to be positively related to market size as measured by GDP. However, in our result, the statistically significant negative effect of GDP with the p<0.001 showed that MFI's performance is sensitive with a change in this macroeconomic variable but the sign effect is in contradiction to our hypothesis as well as the theory which asserts that economic growth enhances profits and downturn adversely affects the interest income. This economic growth improves business environments and lower MFI's entry barriers but it increases competition consequently. In Vietnam, competitive environment in microfinance field is quite high with more and more finance institutions including stated commercial banks, Bank for Social Policies, NGO institutions, Mass Organizations Funds try to expanse their outreach as much as possible to consolidate their positions in microfinance market. In our study period, growth GDP went hand in hand with an increase of inflation led to a rise in cost of fund as well as high pressure to maintain competitive interest rate with State Bank for Social Policies that dampened seriously MFIs' profitability. Besides, the negative effect of GDP to MFI's profitability in the study period may also be due to other reasons including the preference or the choices of clients on deposits than having loans or MFI's utilization of too high proportion of debt in comparison with their deposit for further investment that could create a debt burden and reduce their profitability.

Regulation:

Regulatory status is measured as a dummy having value 1 if MFI is regulated by a banking authority, 0 otherwise. Our result showed that the impact of regulation is statistically significant with the level of 5%. The positive sign suggests that regulated MFIs have more likelihood of good governance system than non-regulated MFIs. This result is inconsistent with the findings of Peter Muriu(2011), Cull et al (2011), Hartaka(2005). However, it goes in line and supports for the argument about the advantage of regulations with respect to MFIs' performances: MFIs need

to be regulated is to protect their customers, especially poor and low- income people, from losing their hard- earned saving. Regulation is also required to prevent bad practices in lending, and to maintain transparent and regular reporting, as well as certain minimum standards for governance and the quality of management. In Vietnam, a growing number of informal microfinance institutions have summited their documents to be licensed to become formal "small scale financial institutions" as official part of the national financial industry. However, the number of allowed registering institutions is still very limited. Being licensed also provides a support to MFIs, particularly in raising capital from the public, and for borrowing capital loan from international organizations. Being licensed is a guarantee for the repayment of foreign currencies after registering loans to the State Bank. In fact, when setting up dummy variables to stand for regulations, we found that the stringency of regulation depends on the legal status of institutions, so that we were not able to determine whether the various types of MFIs faced reporting requirements, regular onsite supervision, .… At the end, to obtain data for the research, we had to take the information of MIX, and on the website of regulatory authorities of microfinance institutions themselves. We also found that formal MFI are still facing many difficulties s in implementing current laws and rules such as taxes, interest rates and liquidity. Therefore, our empirical research suggests that Vietnam's regulation still need to be completed and should create incentives, and not obstacles, for the sector to grow, as we found that MFIs' performance is positively affected by regulations.

As was already mentioned, static analysis can give us only a snapshot on the causal relationships between profitability of microfinance institutions and selected explanatory variables at a given point of time. However, it does not allow us to analyze the possible dynamic persistent effects on profitability which is well documented in the existing literature. To deal with this concern, we use the two step GMM estimators developed for dynamic panel

models. We present hereafter the results provided by this estimation method.

B/ Dynamic panel models

The result of the F tests, as in the case of the static panel models, allows us to conclude that the determinants used in the study can be considered as a providing a significative explanation of MFIs' profitability in Vietnam during the period of the study. All diagnostics tests of the GMM system also give us satisfactory results. P-value of Hansen test is 0.281. Arellano-Bond test for AR(1) in first differences rejects the null hypothesis but it is expected since $\Delta e_{it} = e_{it} - e_{i,t-1}$ and $\Delta e_{i,t-1} = e_{i,t-1} - e_{i,t-2}$ both has $e_{i,t-1}$. The test for AR(2) in first difference is more important because it will detect autocorrelation in levels. Given the p-value=0.069, we cannot reject the hypothesis of no second-order autocorrelation. Given the validity of the instruments and absence of second order autocorrelation, we can confirm for the system GMM dynamic estimators are consistent and robust.

```
Dynamic panel-data estimation, two-step system GMM
```

```
──────────────────────────────────────────────────────────────────────
Group variable: code1                    Number of obs      =       152
Time variable : year                     Number of groups   =        38
Number of instruments = 17               Obs per group: min =         4
Wald chi2(11) =    2604.89                              avg =      4.00
Prob > chi2   =     0.000                               max =         4
```

roa	Coef.	Corrected Std. Err.	z	P>|z|	[95% Conf. Interval]	
roa11	.6684274	.0376178	17.77	0.000	.5946978	.742157
gdp	.5270449	2.126858	0.25	0.804	-3.641521	4.69561
inflationcpi	.7309421	.3776533	1.94	0.053	-.0092447	1.471129
cap1	.0942288	.0270131	3.49	0.000	.0412841	.1471736
par	-.0110967	.0017547	-6.32	0.000	-.0145358	-.0076576
ola	-.0463267	.0208167	-2.23	0.026	-.0871267	-.0055268
oep	.0728457	.0886643	0.82	0.411	-.1009332	.2466245
gr1	-.0002532	.0014617	-0.17	0.862	-.003118	.0026116
size	-.0000267	.0019979	-0.01	0.989	-.0039425	.0038892
Regulated	.0063107	.0108322	0.58	0.560	-.01492	.0275414
Y1	-.0966234	.060133	-1.61	0.108	-.214482	.0212352
_cons	-.0445076	.1322031	-0.34	0.736	-.3036209	.2146058

```
Instruments for orthogonal deviations equation
  Standard
    FOD.(AgLandoflandarea Agvalue size ola oep gr1 Regulated Y1)
  GMM-type (missing=0, separate instruments for each period unless collapsed)
    L(1/4).(roa11 L3.par L3.cap1 gdp L.gdp L2.gdp L3.gdp inflationcpi
    L.inflationcpi L2.inflationcpi L3.inflationcpi) collapsed
Instruments for levels equation
  Standard
    AgLandoflandarea Agvalue size ola oep gr1 Regulated Y1
    _cons
  GMM-type (missing=0, separate instruments for each period unless collapsed)
    D.(roa11 L3.par L3.cap1 gdp L.gdp L2.gdp L3.gdp inflationcpi
    L.inflationcpi L2.inflationcpi L3.inflationcpi) collapsed
──────────────────────────────────────────────────────────────────────
Arellano-Bond test for AR(1) in first differences: z =  -2.60  Pr > z =  0.009
Arellano-Bond test for AR(2) in first differences: z =   1.83  Pr > z =  0.068
──────────────────────────────────────────────────────────────────────
Sargan test of overid. restrictions: chi2(5)   =   4.44  Prob > chi2 =  0.488
  (Not robust, but not weakened by many instruments.)
Hansen test of overid. restrictions: chi2(5)   =   2.44  Prob > chi2 =  0.786
  (Robust, but weakened by many instruments.)

Difference-in-Hansen tests of exogeneity of instrument subsets:
  GMM instruments for levels
    Hansen test excluding group:    chi2(1)  =   1.16  Prob > chi2 =  0.281
    Difference (null H = exogenous): chi2(4)  =   1.27  Prob > chi2 =  0.866
```

According to the results of the system of GMM estimates, the lagged dependent variable is highly significant and positive indicating that the effect of profitability in previous period is very important, implying that the dynamic specification is likely to be more realistic than the static one, confirming the persistency of profitability in practice. The estimated coefficient of the lagged dependent variable (δ value) suggests that current level of profitability will be 66.8% of the previous year level of profitability, irrespective of the current value of the independent variables. Together with the dynamic persistency of profitability, the loan loss provision ratio (PAR), chosen as a proxy for loan quality and capital ratio (capital to asset) seemed to be the two other very important determinant of MFIs' profitability in Vietnam. PAR negative sign showed us that the lower the loan quality in previous periods, the lower profitability of MFIs in the current period. In the static fixed panel model, we could observe the effect of regulation on the profitability. That effect is not high (p<0.5), in the dynamic panel model, so that we couldn't see evidence about the impact of regulation. However, the positive sign suggested the advantage of regulation on MFIs' profitability capability. The result is inconsistent with the findings of Peter Muriu(2011), Cull et al (2011), Hartaka(2005). A growing number of informal microfinance institutions in Vietnam have summited their documents to be licensed to become formal "small scale financial institutions" as official part of the national financial industry. However, the number of allowed registering institutions is still very limited. According to State Bank of Vietnam, being licensed and regulated MFIs have a chance in raising capital from the public, and borrowing capital loan from international organizations. Being licensed is a guarantee for the repayment of foreign currencies after registering loans to the State Bank. However, in Vietnam, the vast majority of MFIs are small and informal and operate as voluntary associations at the local level. It is hard to regulate them. Besides, there are still a lot of obstacles in regulations; for example, regulations on the financial regime were not issued in a timely manner by the State

bank and Ministry of Finance for small scale financial institutions. Moreover, several regulations have been developed specially for small scale financial institutions which were not consistent with the specific operations of microfinance. In fact, when setting up dummy variables to stand for regulations, we found that the stringency of regulation depends on the legal status of institutions, so that we were not able to determine whether the various types of MFIs faced reporting requirements, regular onsite supervision, …. At the end, to obtain data for the research, we had to take the information of MIX, and of the website of regulatory authorities of microfinance institutions themselves. We found that formal MFI are facing more difficulties than informal MFIs in implementing current laws and rules such as taxes, interest rates and liquidity. Therefore, our empirical research suggests that Vietnam's regulation still need to be completed and should create incentives, and not obstacles, for the sector to grow

With regard to the set of macroeconomic factors like GDP growth and inflation, we could see that MFIs' performance is not sensitive to macroeconomic variables. In other words, statistically, the profitability of MFIs is not affected by the macroeconomic condition. It shows that the microfinance sector is relatively resilient in the face of unstable macroeconomic conditions.

| | (1) |
	roa
roal1	0.668***
	(17.77)
gdp	0.527
	(0.25)
inflationcpi	0.731
	(1.94)
cap1	0.0942***
	(3.49)
par	-0.0111***
	(-6.32)
ola	-0.0463*
	(-2.23)
oep	0.0728
	(0.82)
gr1	-0.000253
	(-0.17)
size	-0.0000267
	(-0.01)
Regulated	0.00631
	(0.58)
Y1	-0.0966
	(-1.61)
_cons	-0.0445
	(-0.34)
N	152

t statistics in parentheses
* p<0.05, ** p<0.01, *** p<0.001

CHAPTER 6: CONCLUSIONS AND IMPLICATIONS OF RESULTS

6.0   INTRODUCTION

Microfinance has played an important role in fostering sustainable economic development of many developing countries through the provision of a wide range of financial products and services to the poor, low-income households and micro and small enterprises. Vietnam stands out for the large-sale coverage of its microfinance system, but questions have been raised about the system's long-term sustainability and whether it is achieving the antipoverty impact desired. The interest in finding answers for these issues stimulated our motivation to explore and analyze the factors which influence the development of microfinance in Vietnam. In this chapter, we conclude the thesis by summarizing our main findings. We show how they meet the objectives of the thesis and address research questions that we raised at the beginning of the thesis. Some recommendations are then proposed which are based on the findings of the thesis. Finally propositions for extending this research are suggested.

6.1   MAIN FINDINGS

The development of a microfinance system depends on the sustainability of microfinance industry. Institutions which conduct microfinance activities supply microfinance products and services to the unbanked poor customers. The existing literature shows that microfinance institutions are sustainable if they can maintain a balance between profitability in the long term, keep providing products and services for the clients' benefits, on the one hand, and the supply of social benefits to communities, on the other hand. Therefore, the sustainability of microfinance institutions can be looked at different dimensions related to their innovation capacity regarding sustainability. With that point of view, in order to achieve research objectives, this study firstly assesses the elements that formed finance innovations of Vietnam's MFIs such as product

innovation, process innovation and legal innovation by comparing them with those of two major successful benchmarks in the world. Secondly, the study examined the factors affecting financial sustainability of microfinance institutions using an empirical analysis based on regression models. Main achievements of the thesis can be summarized as follows:

- We briefly described the historical development of microfinance, global microfinance development trends, a broad concept of microfinance, MFIs, microfinance sustainability and how MFIs get financial sustainability (the first two chapters)

- We provided a brief summary about microfinance sector in Vietnam, as well as the social-economic and legal environments. An overview of the institutional players is also presented (chapter 3). For more than the last two decades, Vietnam's microfinance has made substantial progress. The GDP grew year after year, as well as average per capita income, so the people's living standards have gradually improved. The move by the government to allocate significant funds for the rural development was primary necessary condition for poverty elimination in Vietnam rural areas as well as an opportunity for developing the microfinance sector in Vietnam. The Government was also so active in developing experiments of various new forms of microfinance institutions such as credit cooperatives, NGO community, state-owned banks working in microfinance field. Among which, VBSP has the largest number of customer and 100% are active borrowers. The number of customers of VBARD ranks second while People Credit Fund is the third one. Number of customers of semi-official MFIs is relatively small compared to other formal financial institutions but level of access to poor households of VBSP and semi-official MFIs is highly appreciated. Among the financial institutions providing microfinance services in rural markets, only VBARD diversified its beneficiaries: serving household customers and moving toward small and medium enterprises, and agricultural co-

operatives as well. Although the formal and semi-formal financial sector can work quite effectively they have still not fully met the growing demands for loans of the poor, leaving a large berth for the informal credit market to operate. The poor still go to friends, relatives or even private lenders in spite of high interest rates because of the simplicity of procedures of loans in cash. However, the informal sector also has negative effects on the poor including high cost, low quality or undependable availability.

- We have drawn the lessons from the two major experiences, i.e., Grameen Bank, Bangladesh and Bank Rakyat, Indonesia, and we presented a comparative analysis about financial innovation between Vietnam microfinance system and the two above international benchmarks (chapter 4). The important role of financial innovation in microfinance has been widely recognized. Financial innovation is presented through MFIs' introductions of new products, new services, new process, technology a influenced by operating policies or regulatory environment. In chapter 4, we have emphasized the role of flexibility and adaptability in microfinance innovation among countries in which market-drive and customer-centralized are key factor that can lead to the success of microfinance operation Although Grameen Bank and Bank Rakyat, have followed two different microfinance approaches: one focusses on developing sustainable microfinance for poverty alleviation; whereas, the other develops microfinance for profit target. But these two experiences have a common point: their MFIs institutions are deeply embedded in the socio-economic and policy framework of their countries, so that their implementation methodology and operations, as well as their products and services, can meet their poor's demand. In Vietnam, due to low social welfare conditions and high rate of extreme poor or middle poor in population, the government has dual targets: poverty elimination combined with improving the living standard by supporting social welfare

services. In that context, non-profit microfinance institutions have better conditions to grow than microfinance for profit. MFIs can make use of participation of other social partners and their ways of doing microfinance business go in line with the States' development views. However, the control of microfinance by the Vietnamese Government gave less freedom to MFIs that resulted in the weakness of innovations such as: limited capability in mobilizing funds from other sources (the funding sources rely heavily on donations and aids); no autonomy in management and unclear financial governance structure (some of MFIs like Women's Union or Farmer's Union are directly under control of socio-political organizations); monotonous services (almost all MFIs focus on micro credits, other services such as saving, insurance, money transfer… are very limited);….To sum up, in comparison with Grameen bank and Bank Rakyat, MFIs in Vietnam are less dynamic in finance innovations due to both external and internal causes which affect the sustainability of microfinance industry as well as MFIs themselves. Previous literature has shown the existence of a close relationship between the financial innovation and the financial performance of microfinance institutions.

- Traditionally MFIs has been relying on government subsidies and donor funds. However recently, financial sustainability of MFIs is gaining concerns since it is recognized that only sustainable institutions provide long-term financial solution for low income households. As profitability is the most important step towards long term-sustainability, analyzing the determinants of profitability plays a vital role in the policy making process. This conclusion led us to make an empirical study of the determinants of profitability for FIs in Vietnam (chapter 5). The analysis employed internal and external variables covering most aspects of MFI's performance to check whether MFI's capital structure has a significant influence on profitability. Using both the OLS and the GMM techniques for

the estimation of static and dynamic panel data models, we found results in general consistent with the previous international empirical studies, thus confirming the role of profit, and economies of scale in microfinance. We also find that loan quality seemed to be a very important determinant of MFI's profitability in Vietnam. MFI's performance also appears to be sensitive to macroeconomic variables like inflation and GDP growth. They are both positive statistically related to the MFI's profitability, particularly the inflation ratio. Inflation affects MFI's profitability when it is defined in terms of ROA, implying that managers anticipate inflation expectations and adjust interest rates to achieve higher profits. The negative effect of regulation variables on profitability, raises a concern about the effects of regulations on MFI's performances. However, according to the State Bank of Vietnam, the main reason that MFIs need to be regulated is to protect clients, especially poor and low-income people, from losing their hard- earned saving, but also to prevent bad practices in lending, and maintaining transparent and regular reporting and certain minimum standards for governance and the key persons in MFIs. In fact, the government license provides a major support to MFI, particularly in raising capital from public and borrowing capital loan from international organization. It provides also a guarantee for the repayment of foreign currencies after registering loans to the State Bank.

6.2   RECOMMENDATIONS

As mentioned above, the development of microfinance in Vietnam should be seen in terms of the sustainability both of MFIs and of the microfinance system. The microfinance system should be developed to serve not only the living of low-income population but also of microenterprises, small household businesses. To support the development of such a system, the Vietnamese Government should adapt and improve regulation, policy and legal framework to create a more

open microfinance environment for the operation and management of MFIs, basing its policy on international standards and practices. Lessons from international comparison with successful MFIs showed that financial liberalization supports the development of effective microfinancing mechanisms and institutions. Freedom to set interest rate is essential for sustainable microfinance. Currently, some of MFIs do not have autonomy and suitable financial management structures because they are under the authority of Mass Social Organizations.

For the achievement of microfinance sustainability, the Government should recognize and balance social goal with financial goal in the microfinance sector. In the process of developing microfinance industry together with efforts to ensure social security and sustainable poverty reduction, the Government should make clear that microfinance cannot be reduced to charity activities. Therefore, they should be a re-evaluation of the operations by VBSP to help the bank avoid overlapping beneficiaries. For example: The utilization of national budget must be ensured for only effective poverty alleviation. Only extreme poor in remote mountainous areas and disabled persons could have preferential financial aids, other poor people in rural areas who have laboring and earning capacity need to be treated as microfinance clients with market interest rate because they just need to have access to loans to start up their business and then pay back their debt. By so doing, the Government will limit the unfair competition between VBSP and other stakeholders in microfinance fields due to subsidized interest rate policies. This will create motivation for further development of other NGO microfinance institutions.

The Government should also create favorable conditions to establishing agricultural product insurance markets. Currently, insurance products and services are still lacking in microfinance markets although they are the most wanted potential products and services by all poor people who are the most vulnerable to health hazard, economic down-turns, natural catastrophes…

Nowadays, the problem of over-indebtedness is one of the most serious problems of the microfinance sector in developing countries. It happens when many borrowers had been able to take out loans far above their payment capabilities. When over-indebtedness isn't taken into account carefully, microfinance may counteract its own goal of helping the poor out of poverty, instead it leads to negative social impacts. Therefore, microfinance institutions should take care adequately in all credit phase process to be sure that their clients have enough abilities to pay back loans without becoming over-indebted. Vietnamese Government should also have specific regulation aimed at this issue to avoid over-indebtedness for loan borrowers. It could be regarded as one kind of law to protect clients in microfinance field. Each microfinance institutions should build up a documented loan appraised procedure to identify the repayment capacities of clients that show an appraisal of character, payment history, payment capacity of client loan clients Government regulations should also support to share information on credit of microfinance clients among microfinance institutions and considered it as one key solution to preventing over-indebtedness.

The challenge is to develop a stable microfinance system including the need to achieve operational and financial sustainability for MFIs and to ingrate them into the broader financial system. That objective requires MFIs to achieve good governance within MFIs as well as at a system level. In Vietnam, there are several types of microfinance operation models such as state commercial banks like VBARD, people credit funds, NGO microfinance institutions, VBSP, Mass Organizations controlled institutions…Whichever type of institutions, there are a number of key considerations like business goals, competition, regulatory environment, market size and current infrastructure and systems that must be carefully weighed and analyzed. The ultimate success of any model hinges on:

- **Commitment** from board and management and alignment with the institutions' core commercial strategy;

- **Knowledge** of microfinance best practices and how to serve micro-clientele;

- **Infrastructure** located conveniently for clients;

- **Products** especially adapted for low-income and informal markets;

- **Systems and procedures** adapted to the microfinance operations, e.g., systems that support immediate follow-up on missed payments; and appropriate staff training and incentives on new clients, products, and delivery systems

- **Efficient regulation** on protection clients from over-indebtedness and MFI's sustainability achievement

6.3   PROPOSALS FOR FURTHER RESEARCH

For the analysis of factors affecting to the development of microfinance in Vietnam, the thesis was conducted to deal with two main tasks: comparative analysis between MFIs' financial innovation in Vietnam and other international benchmark countries, on the one hand, seeking the determinants to MFI's profitability in Vietnam, on the other hand. However, the research need to be extended by investigating the effect of financial innovation on the growth of MFIs. Using cross-country data and a quantitative empirical regression method, we could analyze how financial innovation by MFIs affect economic growth. We made a comparison of these effects on MFIs' financial performance among three countries.

Regarding factors affecting the profit of MFIs in Vietnam, the thesis has uncovered that inefficiency in the management of operational expenses is associated with declining MFI's profitability. A decline in administrative costs, an increase in staff productivity will influence the profitability of MFIs. Further research could address the impacts of these factors on microfinance

profitability. Lending behavior is also a factor affecting to MFI's profitability. According to Muriu, the shift from joint liability to individual liability loans may accelerate as the microfinance stakeholders learn about some of the demerits of group lending mechanism. Should MFIs pursue individual, group or a combination of both lending mechanisms in order to enhance profitability? This issue remains contestable and deserves further study.

There is still a controversial issue among researchers about whether or not there is a trade-off between MFIs' outreach and profitability. In this thesis, we conducted an empirical study mainly focusing on profitability and sustainability of MFIs in Vietnam. These elements are necessary but not sufficient conditions, for MFIs to play their role. The question of outreach which is a major function of MFIs should also be analyzed to figure out answer for the above controversial issue. Therefore, a future comprehensive study on this topic should be implemented by including scale and depth of outreach indicators, growth stage and age of MFIs as well.

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