Abstract

Since July 1993 the network of People's Credit Funds (PCF) has been gradually set-up. It can be described as formal finance system development from both sides, from above and from below. The initiative to establish the PCF-system has been taken up by the State Bank. It provides a very intensive support in controlling, supervision and training of staff, particularly during the implementing stage. On the other side, the PCF-system is designed as a member-owned organisation, which aims at mobilising savings from its members. It has to be managed according to the economic principle of cost-covering. Whether this built-in inconsistency is an advantage or disadvantage is open to debate.

Up to the end of 1998 there have been 988 Local Credit Funds, 19 Regional Credit Funds and one Central Credit Fund as the apex organisation. The whole system comprises about 600,000 members. While originally a rapid expansion of the PCF-network had been anticipated, it has been agreed upon to have a phase of consolidation by now. It will take quite some time until the PCF-system will become fully operational as a financial intermediary. It is argued that it has an important role to play in providing financial services to the rural population. From the members' point of view the development, advantages and limits of the PCF-approach is discussed.

Introduction

In line with the rapid economic transformation since the adoption of the *doi moi* policy in Vietnam the whole financial sector had to be reorganised. Up to now, this process has not been terminated, yet. With respect to the
agricultural sector and the rural economy the decollectivisation of agricultural production led to the re-emergence of family farms. Similarly, rural non-farm enterprises have been gradually set-up. Both need, among others, a viable rural finance system in order to make full use of their potential and, hence, to ensure an adequate level of income for the rural population. As one of the four state-owned banks the Bank for Agriculture and Rural Development (VBA) had been entrusted with a rural credit mandate in 1990. After the collapse of the rural credit cooperatives in the early 1990s it was quickly realised, however, that the VBA could not fill the void. Therefore, it was decided to set up a revised rural savings and credit cooperative system in a cautious manner since 1993. This system is named People's Credit Funds (PCF).

This paper looks at the development and present state of the PCF-system with an emphasis on the perspective of its rural members. It is based on background papers and interviews with key informants in Hanoi in late 1998. In addition, officials at the provincial, district and commune level as well as chairpersons and members of local PCFs were interviewed in three randomly selected provinces, viz. the provinces of Bac Giang, Quang Binh and Daklak, respectively.

1 General remarks on (rural) savings and credit cooperatives

Since the establishment of savings and credit cooperatives at the middle of last century, they are rooted, like cooperatives in general, in the insight that individual people who have the same economic difficulties achieve more if they unite. They are inspired with the idea not to draw on outside help but rather to improve their situation through their own initiative. Often this self-help approach used to be the only way to get access to financial services at all. In general, people voluntarily group together and form a savings and credit cooperative to take advantage of potential economies of scale in pooling their own meagre individual resources, including the benefit of expert management and pecuniary gains due to stronger bargaining positions. Like the cooperative movement in general savings and credit cooperatives are guided by three major principles, i.e. self-help, self-administration and self-responsibility. Self-help means that people join forces, raise the necessary financial means for the joint cooperative undertaking themselves and are prepared to give mutual help. Self-administration means that the members organise the internal conditions of their cooperative society themselves (“internal democracy”). Hence, the cooperative is not subject to third party's orders. Self-responsibility means that members themselves are responsible for the foundation and upkeep of the cooperative enterprise with respect to business partners in order to establish confidence in economic life (IRU: 9). These principles are reflected in the Vietnamese Law on Cooperatives, effective 1 January 1997.

Basically, cooperatives comprise individuals which voluntarily join a social group (“cooperative society”). At the same time the cooperative represents a business unit which has to be registered to participate in economic life (“cooperative enterprise”). Hence, cooperatives are characterised by their dual nature (DRAHEIM: 16). In addition, there is a two-fold connection between a member and the cooperative. On the one side, a member is a shareholder and therefore co-owner of the cooperative enterprise. On the other side, a member is a client of the cooperative to take advantage of its offers. It follows that members are integrated as holders (i.e. providers of capital or shares), clients (e.g. depositing and/or receiving funds) and decision-makers (or controllers), simultaneously (“identity principle”) (WÖLFLE: 26).

While rules and regulations of all types of cooperatives are outlined in the national cooperative laws and specified in the bylaws of each individual one, savings and credit cooperatives are, in addition, always under the supervision of the financial authorities. In general, these cooperatives are classified as financial institutions or banks, particularly if they pursue non-member business. Hence, savings and credit cooperatives not only fall under the stipulation of the Cooperative Law, but also under the jurisdiction of the Banking Law.

In comparison with banks, in general, savings and credit cooperatives seem to have a certain advantage for the clients when it comes to credit. Although credit risk appraisals conducted by savings and credit cooperatives should not differ from the procedures employed by other banks, the personal integrity of the credit applicants and the economic viability of the proposed investment are seen as more important factors than the provision of collateral. Banks mainly look at the value of collateral first when deciding on credit. The provision with credit based on the availability of collateral does not only seem to reinforce the status quo of the actual asset ownership and income distribution, but even to increase the unequal distribution pattern. In that case only those who own some assets and have a certain level of income, i.e. the better-off, have access to financial resources to improve their economic well-being even further. If, however, the decision to provide credit is based on the prospective rate of return of the intended investment (“economic indicators”) and the personal integrity of the borrower there is the opportunity to
promote the economic and social advancement of economically weaker, but innovative farmers and artisans. The joint liability of the members is one decisive advantage of savings and credit cooperatives provided they pay up an equivalent amount of share capital. Savings and credit cooperatives can even do without the submission of collateral at all as members are forced to repay due to peer-pressure within the cooperative society. In case of non-payment all members will be liable and have to bear the losses (ARMBRUSTER: 232-235).

Besides this effect of supporting economic and social mobility among its members additional factors could be observed. "When a farmer faces a credit constraint, additional credit supply can raise input use, investment, and hence output. This is the liquidity effect of credit. But credit has another role to play. In most developing countries where agriculture remains a risky activity, better credit facilities can help farmers smooth out consumption and, therefore, increase the willingness of risk-averse farmers to take risks and make agricultural investments. This is the consumption smoothing effect of credit. Thus, better rural credit markets may lead to a higher volume of agricultural output and consequently employment and wages than would be attainable with a less developed or less efficient credit system" (BINSWANGER/ KHANDKER: 241).

In order to establish viable savings and credit cooperatives they have to accumulate their own funds. At the beginning these funds are mainly made up by the share capital and the savings of members and, if possible, by non-members. A certain minimum amount of share capital has to be met before a savings and credit cooperative will be registered. Once registered cooperatives have to set-up reserve funds in order to remain economically viable as business entities in case members might cancel their membership. In general, when operational most of the own funds are made up by savings. Members have to be encouraged to save, even small amounts. On the other side, farmers and rural entrepreneurs are in need of convenient and safe deposit facilities for the accumulation and safeguarding of their savings due to two major purposes: consumption and emergencies on the one hand and enterprise self-financing on the other. It is important that there is a positive yield in real terms lest their savings are eroded by inflation otherwise members will look for more safe alternatives. In establishing a track record as a saver, inexpensive information is provided to the cooperative staff, which may enter into creditworthiness examinations. From a member's point of view a savings account may provide more easy access to eventual loans in building up highly liquid partial collateral (SEIBEL, 1996: 102-103).

Savings and credit cooperatives mainly serve their members at the local level. However, at a certain stage, it will become necessary to set-up organisations at a secondary or, even, tertiary level to spread risks due to the effects of seasonality and synchronic timing in a certain region. Savings and credit needs do not need to coincide at the same period for all members. This problem may become very urgent with a highly homogeneous membership structure, e.g. all members are farmers cultivating the same crop. Secondary organisations can channel surplus funds from one region to another and balance them between the needs of various professional groups. The functions of such an apex organisation may not only be to act as the legally recognised financial intermediary, to convey information up- and downwards or to provide training facilities, but also to provide a forum where problems and solutions are discussed (KROPP et al.: 119). In addition, the apex organisation is the best focal point in channeling outside funds into the system without giving an impression to members that "easy" money comes in which does not need to be paid back.

### 2 Limits of the Major Rural Bank: Vietnamese Bank for Agriculture and Rural Development

Since the adoption of the doi moi policy Vietnam has experienced rapid economic growth. The people have witnessed a shift from a centrally-planned economy to one operating on the market mechanism with the following identifiable features (TRAN: ix-x):

1. From an economy in which the state played a decisive role in nearly all economic activities to a multi-sector economy in which the state sector is being restructured and the private sector is encouraged to develop.

2. From an economy aimed at supplying the people with the basic necessities of life to an export-oriented one.

New institutions and organisations had to be developed in order to ensure lasting benefits for the population. With respect to the provision of financial services in the rural areas the Vietnamese Bank for Agriculture and Rural Development (VBA) was foreseen to foster economic growth. While farmers benefited from the political change during the 1980s, their incomes lagged behind those in the urban areas since the early 1990s. A viable finance system is needed not only to stimulate agricultural production, but also to diversify farm activities away from rice
as the main means of improving farm incomes, i.e. other crops but also the integration of animal husbandry into the farming system. Improved technology and water resource development are also regarded as routes to higher farm incomes. But the growing labour force can no more be productively absorbed by agricultural activities only. In addition, non-farm jobs have to be created. These types of activities are expected to grow mainly through more processing of farm products (MARD: 8).

The VBA is the largest provider of financial services in rural areas, with over 2,500 outlets. At the end of 1997 VBA had loans outstanding to 3.66 million households averaging around US$ 430. However, many rural areas are not covered (WORLD BANK: 22). A regional analysis of a survey among rice farmers showed that those in Southern Vietnam had more access to credit than farmers in the rest of the country. But also in those areas where VBA is represented not all farmers have access to its services. In the survey just 38 percent of the rice farmers analysed have access to credit, the far majority among those borrowed from the VBA. (IFPRI: 310).

Although the VBA is by far the most important financial institution in the rural areas, it is still underdeveloped due to various reasons which are interlinked to some extent. A major characteristic of VBA's loan portfolio is the low share (about 20 percent) of medium-term loans. The fundamental factor is the continuing reluctance of people to deposit their savings in VBA (or any other banks) for periods longer than 6-12 months because of the historical experience with high inflation rates and difficulties experienced in withdrawing savings from credit cooperatives as and when required. Most people still deeply mistrust domestic financial intermediaries. Others wish to protect private income streams and financial asset holdings from state control and taxation. Thus, VBA has been reluctant to expand medium-term loans with funds mobilised largely from short-term deposits. A contributing factor seems to be the lack of adequate experience in VBA to appraise medium-term credit applications (ADB: 5). Hence, the situation looks as follows. While the demand for medium to long-term credit is high, the supply is low. Farmers, like other entrepreneurs, in general rely on their own sources of income for investments, extension of more expensive short-term credit and on informal sources (WOLFF: 68).

Another disadvantage are the regulations by the State Bank (SBV) determining interest ceilings for credit which is binding for all financial intermediaries. Up to very recently also the ceilings for deposits have been fixed. To some extent the ceilings of interest rates are fixed by the State Bank due to economic and political reasons: On the one side, it wants to stimulate overall economic growth; on the other side, it wants to reduce poverty through subsidised credit. Depending on the economic sector interest ceilings may be adopted differently but the basic levels are determined by the State Bank (CREUSOT et al.: 54-55). Banks are not able to set interest rates that will cover the costs of funds, operating costs, and risks. Due to this regulation of lending rate ceilings and given the banks' generally high operating costs, they cannot expect additional profits from attracting new deposits by offering higher deposit rates. Hence, VBA itself does not have strong incentives to promote savings and to expand its capital base (KLUMP/SPITZENPFEIL: 9). Banks will only operate in areas where they can be profitable under these controlled circumstances. In this respect, it can be argued that the policy of setting interest rate ceilings which is supposed to stimulate economic and agricultural growth is actually limiting the access to credit and increasing credit costs for farmers and rural entrepreneurs. Since the supply of credit of VBA is rather limited farmers have either to cancel their investment plans or to rely on informal sources. In many cases the access to credit is more important than the level of interest rates and farmers are prepared to pay interest rates to informal moneylenders three to five times higher than the official ones (CREUSOT et al.: 57).

Closely related to the repercussions of setting interest ceilings is the problem of recovering debts in case of default. VBA is demanding for collateral when deciding about a credit application. In principle, residential property, movable assets and goods as well as guarantees by third parties are acceptable as collateral. Even agricultural land use rights might be accepted. However, it is very difficult to cash-in these items or rights. In case of default, VBA is trying to recover the loan with the help of the local people's committee. There is no land market for the time being. In praxis, VBA cannot rent or sell agricultural land. Hence, in most cases VBA just accepts residential property, motorbikes and other durable consumer goods as collateral. Due to this limited availability of collateral private investments are kept lower than it should be (WOLFF: 45). In addition, banks like to provide credit to state-owned enterprises (SOEs). On the one side, the credit amounts are much larger and, therefore, handling costs relatively small; on the other side, risks are more or less non-existent as in case of default the government is supposed to come to their rescue. Often the government is guiding banks to provide credit to SOEs. However, in many cases SOEs are not able to service their loans, and the accumulation of bad loans is ultimately a liability to the government budget and/or might endanger the survival of the banks themselves. Due to this fact there are even less funds available as credit for farmers and rural entrepreneurs (WORLD BANK: 23).
From the clients' point of view the procedures in getting a loan from VBA are still quite complicated. The transaction costs are quite high. It is costly to get the necessary paper work done when submitting the credit application. It takes time and money to go several times to the local branch of VBA. The processing of the credit application takes quite some time. Often credit can only be asked for specific agricultural investments but not for those activities which are of priority to the borrower. Generally, VBA demands the repayment of both, principle and interests, at one time shortly after harvest. So farmers have to sell when crop prices are generally low. In this respect, they lose a part of their potential income. They are better served if they could repay in several instalments (COLLIOT/HO: 62-64).

3 Development of the People's Credit Fund System

After the collapse of the rural credit cooperatives in the early 1990s it was quickly realised that even a well operating VBA could not fill the void left. Therefore, SBV had been entrusted to reorganise a rural credit cooperative system in a cautious and prudent manner. One of the most important objectives had been the need to restore public confidence in the formal rural finance system. Therefore, the term "cooperative" had been deliberately excluded from the name of this newly-established finance institution. Since July 1993 credit unions or a network of People's Credit Funds (PCF) has been gradually established. These credit unions are commune level savings and credit cooperatives, inspired by the Desjardins model. The mobilisation of local idle funds and the provision of credit services are its main functions. Most of the few still viable (traditional) rural credit cooperatives were transformed into local credit fund (LCF)-groups, but most LCFs have to be set-up from the scratch. Three main features characterise the PCF-approach: There is (a) an improved local access for borrowers and savers through controlled transaction costs; (b) a risk-sharing across local lending units, and (c) an emphasis on savings mobilisation and loan repayment (ABIAD: 17). It is the objective that, in the long run, the whole system will become economically viable and can act competitively with commercial banks.

The PCF-system comprises three managing levels, i.e. the local credit funds (LCF), the regional credit funds (RCF) and, on top, the central credit fund (CCF). The CCF, the apex organisation, has been established in August 1995. The RCFs will be established gradually. While all units are legally independent and do their accounting separately, they are interlinked with each other. The three levels have to be integrated in line with their respective functions to ensure a smooth operation of the whole system, i.e. to harmonise the flow of capital over the regions and over time. The functions of CCF are to ensure relations with government and internal-external financial credit organisations, to regulate resources within the system, to make accounting, lending and borrowing services to the whole system. RCFs have the function to coordinate local activities. The LCFs manage direct relations with their members in providing credit and mobilising savings (VU: 3).

Table 1: Development of PCF-Network since 1994

<table>
<thead>
<tr>
<th>Date</th>
<th>Number of LCFs</th>
<th>Number of RCFs</th>
<th>Members</th>
<th>Deposits (mil US$)</th>
<th>Loans (mil US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug. 1994</td>
<td>78</td>
<td>n.a.</td>
<td>33,583</td>
<td>3.8</td>
<td>5</td>
</tr>
<tr>
<td>Dec. 1994</td>
<td>153</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>31 July 1995</td>
<td>200</td>
<td>2</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Dec. 1995</td>
<td>534</td>
<td>3</td>
<td>&gt;150,000</td>
<td>23</td>
<td>35</td>
</tr>
<tr>
<td>30 Sept 1996</td>
<td>847</td>
<td>9</td>
<td>378,978</td>
<td>67</td>
<td>103</td>
</tr>
<tr>
<td>28 Feb 1997</td>
<td>881</td>
<td>9</td>
<td>413,815</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Sept. 1997</td>
<td>923</td>
<td>n.a.</td>
<td>497,000</td>
<td>75</td>
<td>103</td>
</tr>
<tr>
<td>Sept. 1998</td>
<td>988</td>
<td>19</td>
<td>600,000</td>
<td>n.a.</td>
<td>117</td>
</tr>
</tbody>
</table>

Source: JOHNSON: 3; NGUYEN: 11; SEIBEL, 1996: 38; WORLD BANK: 23; personal communication
Once established on a pilot-basis, the PCF-network spread fairly quickly all over the country. This approach proved to be extremely popular and it has operated efficiently. In September 1998, the PCF-system comprised the CCF, 19 RCFs and 988 LCFs. LCFs have been established in 53 provinces already, i.e. in just 8 provinces are there no LCF for the time being. In general, the PCF-system serves the rural population but there are 3 branch offices in Hanoi and 1 in Ho Chi Minh City. In total 9 LCFs are located in the suburbs of both cities. These branch offices and LCFs are serving the urban clientele. The development during the last four years looks as follows:

This rapid expansion of the PCF-network is a reflection of the urgent need by the rural population for viable finance systems. At the end of 1996 membership was increasing even more rapidly than the number of LCFs. While on 30 September 1996 each LCF comprised, on average, 447 members, their number grew to 470 members by the end of February 1997. This increase above proportion can be seen as an indicator for the rising attractiveness of membership in an LCF. Similarly, it reflects a rising confidence of the rural population in the formal finance system (BOSCHERT et al.: 29). During the last two years this expansion has slowed down a bit. The number of members per LCF is still increasing to about 600 persons by now, but the number of LCFs is not growing that rapidly anymore. The popularity of LCFs is quite different in the various communes. In some communes just about 5% of the population has joined, whereas in others more than half of the people has become members.

The expansion rate has been reduced and a phase of consolidation has been agreed upon. One reason seems to be that SBV is not contributing that much funds anymore. In addition, first problems with LCFs have come up. Actually, 4 LCFs had to be closed down in 1998 due to their limited economic viability. It has been planned to organise a review conference during the first half of 1999 to assess the present situation of the PCF-system after the first five years have been passed. It can be assumed that the network will develop at its own speed within the next few years.

Originally, a very rapid expansion of the PCF-network has been planned for the coming years. The designed target for the year 2000 was to have a total of 3,000 LCFs (VU: 6). At that time about 30% of all communes were supposed to be covered by a local credit fund. In the long run it had been envisaged to have an LCF in every second commune. Similarly, the network of RCFs was supposed to be enlarged. While at the beginning it was planned to set-up an RCF in each province, it had been later envisaged to come up with 20-25 RCFs in the end (BOSCHERT et al.: 25-26). However, this objective seems to be difficult to implement as each province is pushing hard to have its own RCF at the provincial level. In these days, the official policy is to set up an RCF-office in all those provinces where at least 20 LCFs are operational.

4 Main Characteristics of the People's Credit Fund System

The set-up of the PCF-system can be described as formal finance system development from both sides, from above and from below. The initiative to establish the PCF-system has been taken up by SBV. It provides a very intensive support in controlling, supervision and training of staff, particularly during the implementing stage. This approach is a good show case for finance system development from above. On the other side, the PCF-system is designed as a member-owned organisation, which aims at mobilising savings from its members. It has to be managed according to the economic principle of cost-covering. It is not designed to receive subsidies by the state; no "easy money" will be available. Since the members own this finance institution, they have the right to participate in decision-making. In this respect, the set-up of the PCF-system is an approach for genuine development from below. Because of its organisational set-up the credit funds fall under the stipulation of the Cooperative Law, effective 1 January 1997. As financial institutions they have to follow the regulations as required by the Banking Law (BOSCHERT et al.: 20-21, 46). A new Banking Law has been adopted by the National Assembly in late 1997 which has become effective 1 October 1998. However, quite a number of decrees specifying the Law still have to be finalised.

With the set-up of the PCF-network it is not only intended to create a viable rural finance system, i.e. it is not supposed to meet economic criteria only, but also to repress "high-interest illusion and unhealthy credit competition in rural areas (and to) promote cooperative spirit among the rural people" (VU: 3). To foster a cooperative spirit seems to be an important feature in running the PCF-system, particularly at the local level. The PCF-system is supposed not only to be managed profitably and to be competitive but also to promote self-help and mutual assistance among its members. This is a distinguished feature in comparison to other commercial banks (VU: 4).

The concept in running the PCF-system is based on two basic principles: to mobilise savings as much as possible and to cover the costs incurred out of the margins in interest rates. The system has to be self-reliant and not dependent on external funds. Within a relatively short period of time, the PCF-system attracted a significant amount
of money in savings. In general, LCFs are performing their services to the membership. Most of the members do have their own saving accounts, but also non-members are invited to save within the PCF-network. However, their number is not very high among the LCFs. On the other side, only members are eligible for credit. Only membership savings and other information about the members provide a certain track record when it comes to lending. Personal reputation is an important criteria. Actually, members protect each other through their own discipline and social pressure. There is one exception to this rule when it comes to the urban branch offices. Here, also non-members can borrow money, but they must have a savings record. The branch offices are more acting like commercial banks.

Due to the close contacts to its members, credit losses have been very small. During these first years, the default rate of the whole PCF-system came up to 1.2% of the outstanding debt. The main reasons had been natural disasters and reductions of agricultural prices (VU: 3). During the last two years share of overdue debts has increased to about 4-5% which is still low compared to the commercial banks, but reflects an underdeveloped level of proper appraisal and monitoring of loans. Within the next few years it is aimed at reducing the share of overdue debts under 3%.

Only, for larger scale loans collateral is required. Since all credits are short-term, the provision of collateral is not a problem for the time being. Only consumer goods are accepted and no land. If medium and long-term credit will be provided in the future, the limited use of land as collateral might pose a problem (BOSCHERT et al.: 34).

Set-up at the local level

The decision as to which provinces will be included in the PCF programme is usually taken at the head office of SBV. It has been started in the more prosperous ones and gradually expanded to the more marginal ones. Provincial SBV branches identify possible communes where the volume of potential business may suffice to support an LCF. This involves an informal survey of the commune and sometimes adjacent communes to assess farm and nonfarm growth potential and the likely number of borrowers and savers in the locality. If the assessment indicates that conditions are favourable, a plan to establish an LCF is submitted to the local People's Committee. The process of formation begins once the local people's committee grants its formal approval (ADB: 41). In this respect, it can be stated that, in reality, the establishment of an LCF is initiated by SBV or its provincial branches and not by interested persons at the local level.

Once the decision has been taken to set up an LCF, a number of steps have to be passed until it becomes operational:

1 With the help of the local people's committees it is looked for 15 potential founding members, the minimum number required for setting-up an LCF. These persons are supposed to have the capacity in managing an LCF. In reality, this requirement is not always met. In one commune in Quang Binh Province which is made up of 6 villages a preparatory committee has been set up comprising the 6 village headmen and 5 future founding members (i.e. the chairman and his two deputies of the commune people's committee, the commune chairman of the Fatherland Front and the former chairman of the defunct supply and marketing cooperative).

2 At the first foundation assembly of the newly formed LCF at least 7 persons have to be present and have to act as founding members. At that assembly the bylaws of the LCF and a workplan for the next two years has to be adopted. In addition, a provisional board of directors has to be elected. In general four staff members have to be identified, a manager who is sometimes also the chairman of the board of directors, a credit officer, an accountant, and a cashier. In larger LCFs the positions of the chairman and the manager (executive director) are separated. In other LCFs, the chairman, a manager and 2 - 3 committee members are elected while the cashier and accountant will be employed. All board members must be approved by SBV at the provincial level, which then issues an operating license for the respective LCF. Particularly those persons who had been in charge of the former credit cooperatives were not accepted as founding members. All these persons need to be better-off than the general public since for founding an LCF a certain minimum level of capital is required.
To meet the minimum capital requirements permanent shares have to be signed. Until 1996, there was no national minimum standard for required capital of LCFs, which was set for each province by the provincial SBV branch. From January 1996, SBV has introduced a minimum capital requirement of VND 50 million (or about US$ 4,400) (ADB: 41). Hence, each of the 15 founding members has to buy minimum shares, or permanent shares, amounting to VND 3.333 million (or about US$ 300) per person. In case the number of founding members is smaller each individual has to sign up a higher amount. As it is reflected in the rapid spread of LCFs, the selection of founding members and raising of the minimum base capital do not seem to be a major problem. In general, the founding members do not have to contribute their shares immediately, but can pay up in instalments over a number of years. Recently, it has been discussed to increase the minimum equity base to VND 100 million.

At the inaugural meeting persons have to be elected to fill the provisional board of directors. Although the Cooperative Law foresees a supervisory board it is not set-up in most cases. Then, just a supervisor is elected or, in some cases, appointed by the board of directors, whose function is to monitor the activities of the management in order to safeguard the interests of the shareholders. The term of office of all representatives comes up to three years, without restriction for re-elections. There are no restrictions about eligibility except the rule that the chairman and the accountant are not allowed to be from the same family. While there are no system-wide educational standards for staff recruitment, secondary education appears to be the minimum requirement. The training for LCF-staff is provided by SBV. There are two types of basic courses: an initial course of two weeks is given before an LCF opens for business; and, at a later time, one-month courses are offered providing detailed coverage. Separate courses are held for managers, directors, credit officers, accountants, and cashiers. All staff training costs are met by SBV (ADB: 43).

3 Once the LCF has been registered and is authorised for providing financial services, it aims at recruiting more members. In general, they are open for all type of persons including the poor. Those who want to become member have to buy a qualification share amounting to VND 50,000 (or less than US$ 5) only. In addition to one qualification share members are free to sign up more shares, including permanent shares. The LCF, as an autonomous institution, has the right to scrutinise applying persons with respect to self-help potential, asset base and reputation (SEIBEL, 1997: 13-14). In general, all applications are accepted. On the other side, depending on the bylaws, the LCF might require from each newly joining member not only to pay up the qualification share, but also to contribute more funds as permanent shares. These shares might cost another VND 200,000 - 300,000 or even VND 1 million, i.e. a multiple amount of the qualification share. Hence, those LCFs are open only for those who have the necessary financial means at their disposal.

4 Shortly after the founding or inaugural meeting, once additional members have joined the LCF, the first general assembly is convened. Actually at that assembly the board of directors is elected and the bylaws finally adopted. In general, the first general assembly confirms the decisions of the founding assembly. While, in theory, all members can stand up as candidates for any position in the self-governing bodies, many bylaws require that all candidates must have signed up a very high level of permanent shares, i.e. far higher than the average member. In this respect, it is ensured that the group of the founding members is eligible for the positions of the self-governing bodies, only.

Once the Cooperative Law had become effective in January 1997 all LCFs which had been set up before that date had to be transformed in line with the regulations of the new law. But, different to the agricultural production cooperatives, this transformation had been a formal act only, as all LCFs had been set-up at a time when the requirements of the various drafts of the new law had been more or less known. Only those few (traditional) credit cooperatives which were still financially viable had to go through the formal transformation process to become an LCF.

All posts of the board of directors and supervisors are honorary. In general, however, these members are
compensated for their activities. The general assembly has to decide on the level of salary (compensation fee). It ranges from a flat rate of VND 100,000 per month for all members to a more differentiated one according to the task performed. Salaries can go up to VND 230,000 for the manager and VND 180,000 for the other elected board members including the supervisor.

In general, one LCF covers the area of one commune. All adult individuals can become member. Usually, there is one member per family who is joining the LCF. However, not all families are opting to become member. In general, 5 - 50% of the eligible persons do join. In general, those who are too poor do not join as they have no extra money to buy a qualification share. Others simply are not interested in getting loans. On the other side, those who are better-off prefer to approach VBA directly, as they get cheaper loans from it. With respect to gender distribution the share of female members oscillates between one and three quarters. Although women are elected to the board of directors, in general they are by far under-represented.

In this respect, the LCFs are characterised by two types of members; on the one side, there are the founding members who have invested quite some money in setting up an LCF. On the other side, there is the general public who have acquired their qualification share for a more nominal sum. The reasons why more prosperous members of a commune provide their money and time seems to be multi-faceted one. The most important ones are the following:

- The election to a board of directors involves an increase of social status and a high degree of decision-making powers. While, as stated in the Cooperative Law, all members have the same rights in decision-making and voting is done on the qualification share, i.e. the cooperative rule "one member - one vote" is applied, in reality, however, the founding members have more weight in taking decisions than the newly joined ordinary members. Only they are eligible for the positions in the self-governing bodies. In this respect, they have a high degree of influence over what is happening with (their) money.
- Financially, the set up of an LCF can become quite attractive provided the LCF is making a profit. Besides the small salary or compensation fee for all members of the board of directors, they might get dividends paid on their shares. In addition, the board members might get an additional bonus out of the net profits, if any. In total, all three sources together might add up to a respectable sum of money compared to other possible ways of investments in the rural areas.

There are restrictions for the founding members when it comes to take decisions on the level of dividends for the permanent shares. The dividends do not have to be higher than the most attractive interest rates on savings. With this regulation it is supposed to avoid any abusive situation that the founding members who have a strong influence in decision-making might act opportunistically and might have more their dividends in mind than the economic well-being of their LCF.

- Others really saw a need in setting up an LCF since there has been no other option in getting access to financial services. Within this group, one has to distinguish between those who mainly saw the need for themselves (i.e. genuine self-help action) and those who saw the need of others while they themselves did not have any problem in getting financial services. The last group might have acted out of altruistic motives to promote self-help.

All LCFs have the right to store their cash in their own safes over night. There are no stipulations to deposit surplus funds with commercial banks as it is the case for various credit unions in other countries.

There is a close relationship between the board of directors and the people's committee members at the commune level. Very often heads of the local branch of the Party and chairmen of the people's committees are members of the board of directors of the LCF, although officially this is not allowed. This overlapping of official functions within a small group is understandable since the number of persons with a certain level of education and social status is limited in the rural areas. Nevertheless, it has to be strictly avoided that local authorities try to influence the activities of the respective LCF. This outside interference had been one of the factors of the collapse of the former credit cooperatives.

Members have the right to cancel their membership. In that case, he or she has to present a letter of cancellation right before the next general assembly. At that meeting the cancellation will be approved and within the next three
days the shares will be repaid.

There is only limited information available about the membership structure of LCFs. It can only be indirectly deduced from the structure of the borrowers. About two-thirds of them are farmers, about 20% are rural traders while about 11% can be classified as rural artisans or small-scale entrepreneurs (BOSCHERT et al.: 30). Due to this professional heterogeneity of its membership two main risks are reduced which often affect financial intermediaries with a highly homogeneous membership structure. On the one side, the effects of seasonality and synchronic timing are not that predominant since savings and credit needs do not coincide at the same periods for all members. Therefore, the financial solvency over the year is more likely ensured. On the other side, credits taken for financing economic activities are spread over quite different purposes. The potential risks of default in undertaking these activities can be better balanced. In this respect, the LCFs can balance the financial problems of their members to some extent (ARMBRUSTER: 231 - 232; BINSWANGER: 119).

Set-up at secondary and tertiary levels

Basically, the internal structure looks as follows: Members join and form an LCF, a number of LCFs provide capital for, form and become members of an RCF, while all LCFs and RCFs have their shares in the CCF. However, during this period of establishing and strengthening the system, SVB and other state-owned banks are still involved as shareholders at the higher levels for the time being. As it was already discussed above, the PCF-approach combines elements of formation from above with the participation of the members in the decision-making process.

Supply and balancing of liquidity among the LCFs is handled by the RCFs; the supply and balancing of liquidity among RCFs is ensured by CCF. A number of LCFs join together in setting up an RCF. However, the next RCF has to be located within a reasonable distance to the LCFs. In case the next RCF is too far away, these LCFs are directly attached to the SBV and the financial services are handled by its regional branches. In the long run, it is envisaged that each LCF will be member of an RCF. The share capital of the RCFs is kept by the LCFs within its area. In addition, shares are owned by SBV which are supposed to be sold to (newly-established) LCFs in the long run. The minimum share for each LCF amounts to VND 5 million (or about US$ 450). Each LCF has to contribute the same amount for getting its share at the CCF. Those LCFs which are not member of an RCF contribute VND 10 million directly to the CCF (BOSCHERT et al.: 26).

The CCF is managed in the legal form of a cooperative. The equity capital stands at VND 200 billion (or about US$ 17.7 million), of which 40% are held by SBV. The share of the state-owned and private commercial banks is limited up to 30%. Up to the end of 1996, VND 108 billion have been paid in. SBV contributed VND 80 billion, the four state-owned banks VND 20 billion, and one joint-stock bank VND 2 billion, while the RCFs and LCFs just managed to pay in VND 6 billion, so far. In the long run, it is envisaged that RCFs and LCFs take over all shares held by SBV and the other banks (BOSCHERT et al.: 28).

Economic performance

The advantages of the PCF-system can be summarised by two features: (a) the close proximity to its members and clients, and (b) the simplicity to get access to its services. Therefore, the initial growth has been quite remarkable. By the end of 1996, savings by the members amounted to VND 752 billion (or US$ 67 million). At that time, savings per member came up to about US$ 170 on average which has been remarkable keeping in mind that the average income per capita in rural Vietnam stood at about US$ 100. Within the first few years savings have been increasing rapidly, e.g. within the second half of 1996 by about 42% (BOSCHERT et al.: 31). During the last few years savings do not seem to have grown that rapidly anymore. The number of new members grew relatively much quicker than the total amount saved (see Table 1). The reason seems to be that not so prosperous persons joined the system, but also other formal and informal savings options might have become more attractive. Saving interest rates paid out to the members at the end of 1998 stand at around 1% per month, from 0.9% per month for three months deposits to 1.2% per month for 12 month deposits. One of the major drawbacks, so far, is as with the VBA the total lack of saving products for medium and long-term purposes. Therefore, about 90% of all savings are put in three-months deposits.

The volume of credit provided to the members increased quite rapidly as well. For example, by the end of 1996, it stood at VND 1,121 billion (or US$ 103 million). Due to the fact that almost all loans are of a short-term nature, the real volume of credit available over the year seems to be higher. There is no regulation on minimum or maximum
loan sizes, other than the overall limitation that no single loan can exceed 10 percent of the capital of the respective LCF (ADB: 43). The average amount of credit came up to US$ 315 in 1996. The average interest rate asked for loans for a period of six months stood at 1.2%-1.5% per month by the end of 1998. This rate was somewhat lower than the upper limit of 1.5% per month set by SBV.

One of the reasons, why the rate of bad loans standing at about 4-5% of all loans provided is relatively low, seems to be the liability of the board of directors in case of default. If the credit cannot be fully repaid by the member and/or the value of the collateral is not meeting the loss, the board of directors has to cover the balance. Since, in general, the manager, chairman and the credit officer sign the credit approval, they are liable, but to a different degree: 70% of the loss has to be refunded by the manager, 20% by the credit officer and 10% by the chairman. In case the manager has signed only, i.e. in most cases smaller amounts up to certain limit stipulated by the respective bylaws, he/she has to cover the bill alone.

Due to the ceilings on credits set by SBV the margins cannot be decided by the PCF-network or in competition with the other banks. During the 1998 the margins between savings and lending rates have become quite small. At the LCF-level margins come up to 0.3 - 0.5% per month. So far, these margins have been high enough for most LCFs to cover their costs and to earn a small surplus. The CCF just calculates with an interest margin of 0.15 - 0.20 % per month to cover its costs. Nevertheless, this interest margin has been high enough to cover all administrative and transaction costs of the PCF-system. In 1996, there had been an overall profit of about US$ 3.4 million which is a precondition in achieving its goal of long-term viability (BOSCHERT et al.: 32-33). Part of its funds have to be refinanced by SBV. The interest rate on these funds stood at 1.2% per month in early 1997. Due to the fact that the saving rates are lower there is a strong incentive for the LCFs to mobilise savings to broaden their capital base (SEIBEL, 1997: 24). At the end of 1998, this positive picture changed a bit. Now LCFs could get funds from CCF at 0.95% per month which was more or less at the same level as interest rates they paid for the deposits of their members. Whether this fact might weaken the effort to mobilise savings cannot be answered at this stage.

The statement on profitability needs to be interpreted cautiously for several reasons. First, within the PCF-system no provision for loan losses is made. Although the losses so far have been relatively small, it is essential to make such provisions against potential losses, particularly as LCF operations will expand and loan maturities are lengthened. Second, LCFs pay no income taxes during the first two years, and a 50 percent concession for the following two years. Third, LCFs receive various direct and indirect subsidies. The local people's committees usually provide free office space for LCFs, at least in the early years. SBV provides accounting forms and stationary free of cost for the first year of operation. LCFs do not bear any costs relating to staff training, supervision activities, and advisory services provided by SBV. (ADB: 43)

**Preliminary Assessment**

Since its inception a number of advantages have been connected with the PCF-system. It has been stressed that they are owned by the members and the policy-making leadership is drawn from the members themselves. This local ownership reduces credit risk and provides peer-pressure incentives to repay loans. LCFs can offer services at low transaction costs because their proximity to and familiarity with clients. Their small size permits adoption of simple procedures; their proximity to potential clients can facilitate mobilisation of small deposits. Moreover, the local ownership will exert pressure on LCF-managers to be responsive to local requirements and efficient in their operations. Because they can have inexpensive access to information on loan applicants and monitoring mechanisms to ensure reasonable repayment rates. Thus, access to financial services is improved for local people. (ADB: 6).

For most of those who are members of an LCF, the financial services offered are quite attractive. Credits are tailored to the needs of the clients. Credit applications are quickly processed. It just takes about two days to come up with the decision. The paper work is kept to a minimum. In comparison, credit applications with the VBA need a long time until a decision is taken. Generally, it takes about 10 - 15 days, often even more than a month. In addition, people feel that the application process with VBA is more cumbersome. But also getting credit through a semi-formal credit group might take quite some time due to the irregular meetings of the credit committees (SEIBEL, 1997: 23).

In most communes, however, LCFs are mainly competing neither with VBA nor the various micro-finance schemes, but with the informal sector. In short, it can be stated that the rapid spread of the PCF-network reflects the urgent need for rural financial intermediaries. The network is still not fully operational, yet. As it is envisaged the
network has to be enlarged and strengthened within the next few years. Because of the bad experience in the past the cautious approach of expansion has to be commended. It is based on savings mobilisation, loan repayment and cost-covering out of the margin in interest rates. First small profits could be managed. No open subsidies or "easy money" are provided by outside sources. However, SBV provides a lot of services in making sure that the PCF-system will become a viable financial intermediary in the long run. Some of them like the provision of training might be seen as a hidden subsidy.

Those LCFs which make a profit (i.e. receipts are higher than costs) and are operational for more than two years are taxed by a 45% profit tax. Of the net profit (i.e. after-tax profit) the dividends on the shares are paid. In general, the board of directors knows very well that the equity base of their LCF has to be broadened year-by-year. So far, the level of dividends is set by the actual interest rate on deposits. Additional profits are booked to the reserve funds, including risk funds and social funds.

5 Problems Encountered in Expanding the People's Credit Fund System

Although the set-up of the PCF-system has been assessed positively so far, a number of problems had to be faced which reflects the fact why consolidation of the system is stressed for the time being. So far, there is no competition with VBA or any other bank. The volume of savings and lending as well as its number of members (and clients) is still quite small compared to the respective figures of VBA. It is estimated that the PCF-network covers about 5% of the rural clientele. The following points seem to be of major concerns which will have to be addressed in the future:

- Up to now, only short-term saving facilities (i.e. for a period up to six months) are offered by the banks including the PCF-network. Due to the bad experience with high inflation rates and the collapse of the credit cooperatives in the recent past people are said to be reluctant to leave their money with financial intermediaries for long periods. Hence, LCFs have so far granted only short-term loans. Most loans have a maturity of less than four months. This concentration on short maturities reflects the concern to avoid a mismatch between maturities of loans and deposits and their efforts to reduce credit and interest rate risks. LCFs also lack staff with skills in appraisal of medium-term loans. But farmers and rural entrepreneurs have to increase their efficiency and productivity further to stay competitive. In order to do so, they are in need of medium and long-term credits. These credits should be financed as much as possible by long-term savings in order to limit a dependence and higher interest rates due to the need of refinancing through SBV and other commercial banks. While it is important to increase the supply of medium-term credit in the rural areas, risk considerations tend to suggest that LCFs should lengthen the maturity of loans gradually (ADB: 5-6). In 1998 international donors provided a collateral insurance funds coming up to US$ 14 million which will open the opportunities to provide medium to long-term loans.

- Besides, business activities of the PCF-network are limited by the interest ceilings set by SBV. As was discussed above, for the rural population the most constraining factor in getting access to credit is not the level of the interest rate, but getting access at all. The interest rates should be determined by market forces in order to force the PCF-network to offer competitive financial services to its members. For the time being, the growth potentials of the whole system seem to be somewhat restricted by these interest ceilings. While the ceilings for savings have been abolished, the ceilings for credit are still in force which definitely limit the level of interests payable on savings. Hence, these cannot be stimulated as much as there is potential. There is no leeway to offer attractive interest rates for medium-term savings.

- On the other side, the whole PCF-system is characterised by the fact that surplus funds were deposited with VBA and other commercial banks. During the last years about VND 100 million (or about 7% of the annual savings) had been "parked" with other financial intermediaries. At the first glance this is contradictory to the first both statements when it was argued that there is a shortage of funds. Actually, it is not but it shows that the PCF-system is weak in channeling surplus funds effectively within the RCF and CCF-network to the areas of demand. Many LCFs seem to be working in their small restricted local area but not yet as partners in the whole system. Up to now, there is only the optional rule for both LCFs and RCFs to deposit surplus funds within the PCF-system, but it is not compulsory. Ultimately, the funds raised should stay within the system.
While during the first years LCFs and RCFs are exempted from paying taxes, they finally have to pay a 45% profit tax. Starting from January 1999 this tax has been replaced by a value-added tax whose rate stands at 32%. Concerning taxes, all LCFs and RCFs are regarded as banks and not as cooperatives. Actually, each LCF and RCF is taxed separately. This is still a critical issue as the PCF-system is supposed to help the rural people and it is argued that the tax rate should come up to 10 - 15% only. Hence, in some micro-finance projects it is discussed whether it makes sense to become an LCF in the long run since they will be taxed quite highly. For the time being, it does not seem to be economic to formalise informal savings and credit groups which will meet the minimum capital base of VND 50 million if they are mainly engaged in a local economic cycle.

The improved access to rural financial intermediaries has been identified as one major requirement to reduce rural poverty. While the price for acquiring a qualification share seems to be low, it seems to be too extensive for most of the poor. Most of the members are those rural inhabitants who can afford to pay for the minimum share and to have regular savings, i.e. those who are better-off (DAUBERT: 2). The average amount of credit standing at about US$ 315 in late 1996 seems to confirm this statement. Therefore, the PCF-system only has a limited role to play with respect to reducing rural poverty. Its major accomplishment will be to provide a viable rural finance system to farm and small entrepreneurial households to stimulate economic development which contributes to poverty eradication, indirectly. On the other side, the rich in the villages are not so much interested in joining the PCF-network since they need larger amounts of credit for longer periods which might be offered by VBA (SEIBEL, 1997: 14; MARD: 29). So far, the PCF-network has been established predominantly in those areas which are economically better-off and infrastructurally better developed. Since the PCF-system has to become viable first, this approach is understandable. In the next years the network has to spread more equally all over the country and to cover the marginal regions as well.

6 Conclusions and Recommendations

The PCF-system has an important role in stimulating the rural economy in Vietnam. In order to play that role effectively, the system has to be strengthened. Based on the discussions in Hanoi and selected provinces and looking from the members' point of view the following points seem to be most urgent.

- Each LCF represents not only a bank but also a cooperative society. So far the banking and financial aspects have been emphasised, i.e. the emphasis has been on the cooperative enterprise. However, LCFs are also self-help organisations. In this respect, it is important to develop an associated life within the PCF-system, in order to strengthen trust and confidence within the system. In this respect, the proposed confederation of LCFs has a vital role to play.

- So far, no medium and long-term savings and credit services are available within the PCF-system. These financial services, particularly credits, have to be available so that farmers and small-scale entrepreneurs can make the necessary investments in order to participate at economic development. In the long run, members will only stay if these services will be offered.

- Similarly, loans can be provided to individuals, only. Hence, individuals are liable in case of default. There is no experience in allocating credit to joint liability groups, if e.g. a group of members were to apply jointly for a credit. In late 1998 a first pilot project about group lending to women entrepreneurs has been started in 8 LCFs. In addition, these loans are on a medium-term basis.

- The provision of medium and long-term loans will not only improve the investment options of farmers and rural entrepreneurs, but can also open the way in supporting farmers and agricultural workers to acquire shares of newly equitised agro-industrial companies. This is particularly interesting for those farmers who rely on certain companies for their inputs or for processing of their agricultural products, e.g. bulky perennial crops. Since most farmers do not have enough cash available to buy name shares of newly equitised companies they are in need of loans which they can pay back over longer periods. The PCF-system could act as an intermediary. Evidently, this requires the availability of medium to long-term savings products and, hence, a deep trust of the members in their system.
The PCF-system will not only improve saving and credit services among the rural population, but should develop new fields of activities. LCFs might act as representatives of farmers / future shareholders when agro-industrial complexes (state-owned enterprises) will be equitised. They will represent farmers in the general meetings of newly equitised joint stock companies and in the board (if no other type of farmers’ organisation takes over this duty). In this way, a large group of individualised small shareholders will speak with one voice and farmers will have a strong influence in the decision-making process. Furthermore, these LCFs can assist both, the farmers as well as equitised joint stock companies in selling name shares.

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