

VIETNAM WOMEN'S UNION

IDENTIFICATION REPORT

PROJECT

**“Strengthening of the Institutional Capacity
of Vietnam Women’s Union
in Managing Credit and Savings Programs in favor
of Rural Poor Women”**

PHASE 3

1 April 2005

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List of Acronyms and Abbreviations

| | |
|--------|---|
| ADB | Asian Development Bank |
| AusAid | Australian Development Aid Cooperation |
| BDS | Business Development Services |
| BTC | Belgian Technical Cooperative |
| CCF | Central Credit Fund |
| CGAP | Consultative Group for Assistance to the Poorest |
| CIDA | Canadian International Development Aid |
| CPRGS | Comprehensive Poverty Reduction and Growth Strategy |
| DFID | Department for International Development (United Kingdom) |
| DGDC | (Belgian) Directorate General for Development Cooperation |
| EU | European Union |
| GDP | Gross Domestic Product |
| GoVN | Government of Vietnam |
| HEPR | Hunger Eradication and Poverty Reduction Plan |
| HR | Human Resources |
| IFAD | International Fund for Agricultural Development |
| (I)NGO | International Non-Governmental Organization |
| JBIC | Japan Bank for International Credit |
| JSB | Joint Stock Bank |
| KfW | Kreditanstalt für Wiederaufbau |
| LFA | Logical Framework Approach/Analysis |
| LIH | Low Income Household |
| LPC | Local People's Committee |
| LUC | Land Use Certificate |
| MDGs | Millennium Development Goals |
| MFI | Microfinance Institution |
| MFP | Microfinance Provider |
| MFWG | Microfinance Working Group |
| MIS | Management Information System |
| MO | Mass Organisations (Women's Union, Labourers Union, etc) |
| MOLISA | Ministry of Labour, Invalids and Social Affairs |
| MPI | Ministry of Planning and Investment |
| MPMU | Microfinance Performance Monitoring Unit |
| OPEC | Organization of Petroleum Exporting Countries |
| PAR | Portfolio at Risk |
| PCF | People's Credit Fund |
| (P)PMU | (Permanent) Project Management Unit |
| PSC | Project Steering Committee |
| RSHB | Rural Shareholding Banks |
| SBV | State Bank of Viet Nam |
| SME | Small and Medium-scale Enterprise |
| SOCB | State-Owned Commercial Banks |
| TA | Technical Assistance/Assistant |
| TOR | Terms of Reference |
| UNDP | United Nations Development Programme |
| VBARD | Vietnam Bank for Agriculture and Rural Development |
| VBCP | Vietnam-Belgian Credit Project |
| VBSP | Vietnam Bank for Social Policy |
| VND | Vietnamese Dong (legal tender of Vietnam) |
| VWU | Viet Nam Women's Union |
| WB | World Bank |

1. Executive Summary

The political and economic environment for the proposed third phase of the Vietnamese-Belgian Credit Project (VBCP) is assessed as stable and improving. The economic dynamism in Viet Nam provides a solid foundation for the integration of sound microfinance into the overall financial system.

The rapid economic development results in changing demand structures, also among the poor, which semi-formal microfinance has been slow to respond to. Formal financial institutions in Viet Nam play a dominant role in provision of microfinance services, and reach deep and wide into the poorer segment of the population, offering relatively well-adapted services, and often applying sound linkage methodologies like the Framework Agreements with the Mass Organizations. There are thus strong push-and-pull forces towards what in microfinance is often termed "graduation". The existing poverty levels especially in rural, remote areas do, however, indicate a continued need for microfinance.

The microfinance sector is not well defined in Vietnam, neither at the policy-level, the demand nor the supply side, reflecting a somewhat immature market. There is still a widespread tendency to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be fed by subsidies. Rich and poor people alike need continued access to financial services that are not restricted in time and scope. This can only be provided by demand-driven and sustainable institutions, which can set cost-covering interest rates. Until microfinance is treated as a commercially viable market segment, it will be difficult to establish financially sound microfinance operations, even with the legal basis that may be provided under the upcoming Microfinance Decree.

Among the semi-formal providers, few have microfinance as their exclusive focus, and the level of Good Practice knowledge and adherence is not high. Semi-formal service provision is fragmented and coordination among the many stakeholders is limited. The overall outreach and performance of the segment is largely unknown. The Vietnamese microfinance market leaves little room for providers that may be historically or structurally disadvantaged by diluted focus, scattered outreach, and limited skill.

Like the other MOs, VWU does not necessarily aim at becoming a specialized microfinance institution. The implications of the Draft Decree is that their current microfinance projects would have to be constituted as separate legal and financially sustainable entities, or simply spun off. The VWU has decided not to embark on a possible transformation into an MFI for the duration of the VBCP Phase III, but rather to compile the information necessary to take an informed decision on this matter before the end of the project.

The VWU does possess significant comparative institutional strengths in promoting economic empowerment among poor, rural women by facilitating their access to financial and non-financial services. In addition, the VWU is well placed to support the development of a more professional microfinance industry in Viet Nam by introducing a standardized reporting format complying with international accepted Good Practices.

During VBCP Phase I-II, important lessons have been learned that have informed the design of Phase III as much as the market analysis. As such, the Identification Mission recommends an adaptation of the project structure and approaches within the framework

agreed by the Vietnamese-Belgian Joint Commission in December 2003 to ensure that Phase III will benefit from the strengths of VWU, while positioning itself as a facilitator of microfinance, rather perhaps than a provider in the longer term.

The adaptations are reflected in the 3.5-year Phase III of the VBCP recommended, which will contribute to the general aim of poverty reduction through a decentralized and performance-based results framework including:

- Access to sustainable financial services for poor women through linkages to banks;
- Access to demand-driven business development services for poor women through strategic alliances with service providers;
- Microfinance sector support through the introduction of standardized, comparable and reliant performance monitoring;
- Efficient project management through performance-based planning cycles.

The project design is summarized in the Logical Framework Matrix overleaf. The indicative budget framework for Phase III is Euro 2,708,900. In addition, Euro 233,670 are proposed allocated for preparatory activities within the Extension (Apr - Dec 2005) of VBCP Phase II from the existing budget.

At the request of the DGDC at the final debriefing for the Identification Mission, and to better reflect the new key roles of the VBCP Phase III, The Identification Team would like to propose the of the VBCP changed to "ACCESS": Access to Coordinated Credit and Enterprise Support Services. The Formulation Mission may have a better suggestion for a new name for the VBCP.

This Final Identification Report presents the findings and recommendations of the Identification Team and incorporates the comments received by DGDC, BTC and VWU to the Draft Report submitted on 24 November 2004. The views and recommendations expressed in this report are those of the Consultants, and do not necessarily represent the views of Vietnamese microfinance stakeholders, nor of DGDC/BTC.

**DRAFT PROPOSED LOGICAL FRAMEWORK MATRIX: VBCP PHASE II EXTENSION AND PHASE III (ACCESS)
PERIOD: EXTENSION APR-DEC 2005; PHASE III: JAN 2006 – JUN 2009**

| DESCRIPTION (see Sections 7.2 and 7.3) | VERIFIABLE INDICATORS (see Sections 7.2 and 7.3) | SOURCES OF VERIFICATION | CRITICAL ASSUMPTIONS (see Section 7.5) |
|--|--|--|---|
| <p>Goal: The incidence of poverty is reduced by 40% among households in Viet Nam by 2010, as compared to 2000</p> | <p>The incidence of Poverty reduced by 33 % by June 2009</p> | <p>Mapping by Interministerial task force</p> | <p>Continued high and equitable economic growth, supported by a stable and conducive economic and political environment</p> |
| <p>Purpose: By end of June 2009, XX % of economically active poor households in Viet Nam has access to high-quality and diversified financial and business development services, provided by coordinated and market-responsive providers following Good Practices for sustainable service delivery.</p> | <ul style="list-style-type: none"> ▪ Outreach to poor clients by semi-formal MF programs reporting reliable data increased by min. 20% p.a. ▪ Microfinance portfolio of regulated financial institutions increased by min. 10% p.a. ▪ BDS providers meet min. 80% of the documented demand of solidarity groups of poor clients. | <p>VBCP Progress reports MFWG database/reports Annual reports from M/FIs VBCP Progress reports, Needs assessments & Directorates</p> | <p>Legal framework for MFIs in place. Distortions in the MF market reduced. Free BDS market allowed to develop. VWU will not be made a new political lending vehicle.</p> |
| <p>Result 1: By the end of June 2009, XX % of poor women in the targeted Provinces has access to diversified financial services provided by regulated financial institutions.</p> | <p>No. women accessing services from regulated financial institutions in the targeted provinces increased by min. 25% p.a.</p> | <p>Consolidated Province PMT reports Annual reports from banks</p> | <p>New Decree/regulations are conducive to MF growth. Banks continue to expand outreach based on the Framework Agreements with the MCOs in targeted provinces</p> |
| <p>Result 2: By the end of June 2009, XX % of poor women in the targeted Provinces have access to demand-driven training and business development services provided by public and private suppliers.</p> | <p>No. women accessing training and BDS services in the targeted Provinces increased by min. 30% p.a.</p> | <p>VBCP Progress Reports</p> | <p>BDS markets expand and develop in the targeted provinces, with support of GovN and other donors.</p> |
| <p>Result 3: By the end of June 2009, a Good Practice-based microfinance industry reports reliable performance data and advocates for a conducive regulatory environment, and VWU has determined its future role in microfinance.</p> | <ul style="list-style-type: none"> ▪ Min. 10 MF providers and 4 donor agencies have adopted and use a standardized performance reporting format by end of project ▪ When effected, the Microfinance Decree and Regulations are acceptable to min. 50% of MFWG members ▪ A 3-5 year Strategic Business Plan for the VWU is adopted by VWU leadership by end of project | <p>Format signed by MFPs/donors, reports available from MFWG MFWG meeting minutes Regulations Strategic Business Plan</p> | <p>MF stakeholders agree on coordinating activities, and accept common format. Decision-making and authority is delegated to technically competent management units in VWU</p> |
| <p>Result 4: An efficient management structure for the VBCP ensures results-oriented and performance-based progress and accurate expenditure controls.</p> | <ul style="list-style-type: none"> ▪ Targets set in Annual Plans are met. ▪ Progress reports and financial accountabilities are accurate and on time. ▪ Appropriate exit strategies are developed, adopted and executed before the end of Phase III. | <p>VBCP Progress reports PSC approvals of disbursements VBCP Progress reports</p> | <p>Funds and other inputs are disbursed timely to the Project. VWU leadership supports new roles of Project.</p> |

| DESCRIPTION | VERIFIABLE INDICATORS | MEANS OF VERIFICATION | CRITICAL ASSUMPTIONS |
|--|--|--|---|
| <p>Main Activities for Result 1:</p> <p>1.1 Segment the current clientele</p> <p>1.2 Update the Savings Product</p> <p>1.3 Link Resourceful clients to Banks</p> <p>1.4 Provide 'Incubation Loans' to Poor clients</p> <p>1.5 Compile and Report VBCP Performance Data</p> <p>1.6 Compile and Report Province Microfinance Data</p> <p>1.7 Develop exit strategy for Use of Loan Fund</p> | <p>Total number of VBCP groups</p> <p>Total number of members in VBCP groups</p> <p># VBCP group members with Poor Household Certificate</p> <p># VBCP group members with priority Residency Certificates</p> <p>Number of groups formed in ethnic minority communities</p> <p>Annually revised client segmentation available</p> <p>Number of VBCP group members with passbooks</p> <p># VBCP members with voluntary savings</p> <p>Interest rate and interest paid to clients on savings</p> <p>Value and usage of Members Mutual Fund</p> <p># clients by category taking first and subsequent bank loans</p> <p># clients with external loans withdrawing savings from VBCP as % of total drop-out</p> <p>% total savings mobilized in VBCP and bank custody</p> <p>Deposit reserve ratio</p> <p>Value and number of VBCP loans disbursed</p> <p># clients by category taking first and subsequent VBCP loans</p> <p>Number clients and value of outstanding VBCP loans</p> <p>% portfolio financed by compulsory and voluntary savings</p> <p>Average loan term (in months)</p> <p>Drop-out rate by category</p> <p>Training of staff in PMT tool and ratios by end October 2005</p> <p>PMT monthly reports tally with MB in all Province PMUs</p> <p>Quarterly Prov. PMT reports consolidated at Central PMU</p> <p>Timely quarterly reporting by all VBCP in the PMT by 2006;</p> <p>Narrative quarterly reports analyse results</p> <p>% microfinance projects by Province using PMT format;</p> <p># Prov. VWUs reporting performance in PMT format.</p> <p>Workshops with TA held for all 17 Province PMUs</p> <p>Prov. PMUs submit proposals for divestiture of portfolio</p> <p>Prov. PMUs submit proposals for investment of Loan Fund</p> <p>Proposals approval by Project Steering Committee</p> <p># Prov. PMUs divesting portfolio to sustainable MF providers</p> <p># Prov. PMUs investing VBCP Credit Fund</p> | <p>Baseline Segmentation Report</p> <p>Revised Segmentation Reports</p> <p>Passbooks, Progress Reports</p> <p>PMT portfolio Report, MB</p> <p>VBCP Progress Reports</p> <p>PMT Reports</p> <p>PMT Reports</p> <p>PMT Reports</p> <p>PMT User Guide, Training Reports</p> <p>PMT/MB Reports by end 2005</p> <p>Consolidated PMT report by end 05</p> <p>17 +1 Quarterly PMT Reports 31.3.06</p> <p>17+1 Narrative Progress reports</p> <p>Progress Reports</p> <p>Progress Reports</p> <p>TA reports by Feb Year 4</p> <p>17 proposals received by March Year 4</p> <p>PCS meeting minutes by April Year4</p> <p>VBCP progress Report, 2nd Qu/Yr 4</p> <p>VBCP Phase III Evaluation Report</p> | <p>Timely TA is Contracted</p> <p>Timely TA is contracted</p> <p>Timely TA is contracted</p> <p>Timely Audits are contracted</p> <p>Banks accept new clients from VBCP.</p> <p>Timely TA is contracted.</p> |

| DESCRIPTION | VERIFIABLE INDICATORS | SOURCES OF VERIFICATION | CRITICAL ASSUMPTIONS |
|---|--|---|--|
| Main Activities for Result 2: 2.1 Conduct Needs Assessments to Determine Demand | # VBCP staff consulted on design of the Assessment format # clients responding to the Needs Assessment by year Draft baseline assessment circulated within 17 Provinces Consolidated Assessment disseminated by HO by 12/05 Annually updated Assessments done | TA/PMU Progress Reports Assessment Report Prov. PMU Progress Reports 3 rd Qu/05 All Prov. VWU have Assessment Updated Assessments from 17+1 PMUs | |
| 2.2 Compile and Distribute Training and BDS Directory | Standardized registration format for Service Providers # Prov. PMUs publishing Directory per year # BDS service providers in Province Directories per year # Directories produced and sold # Non-VBCP Prov. VWUs replicating & producing Directories | Registration Format Directories Prov. PMU Progress Reports Central PMU Progress Reports | Good cooperation with local government officials and extension agencies continues. |
| 2.3 Develop Strategic Linkages with BDS providers | # groups/centers/members trained/receiving BDS per year # providers in Directory contracted by VBCP per year, # Agreements signed by PMUs with providers per year; | Prov. PMU Progress Reports Agreements for service provision | |
| 2.4 Monitor, Evaluate and Report Performance | # trainings/BDS events evaluated by number of participants; Average participant evaluation score of contracted providers; % demand per Assessment which can be met by supply (as per Directory) per year % demand actually met per year # Prov. PMUs/stakeholders receiving quarterly reports Timely response by HO to requests for assistance | Prov. PMU Progress Reports Participant Evaluation Forms/Directories Prov. PMU Progress Reports List of recipients of Prov. PMU reports Prov. and Central PMU Progress Reports | Timely TA is contracted |
| 2.5 Develop Cost-Sharing Models for BDS services | Average cost of trainings/BDS events per year Average value of client contributions by event per year % of total cost per training/BDS event covered by clients % of total cost per training/BDS event covered by PMUs # cost-sharing models used by Province PMUs per year # PMUs managing activity-based budgeting and accounting # VWUs adopting activity-based budgeting and accounting | Prov. PMU Financial Progress Reports Prov. PMU Progress Reports Central PMU Progress Reports | |
| 2.6 Establish BDS and TA Matching Grant Fund | Procedures for the Fund consulted and finalized by Dec 05 # and value of Fund applications received by date, by Province and by type of training/BDS/TA per year; Number and value of grant disbursements by date per year; # accounts and reports received and approved per year; % of TA applications approved using Internal VBCP staff % of TA applications approved contracting external resources in Vietnam % of TA applications approved contracting international resources | Fund Procedures simple, transparent Central PMU Progress Reports Central PMU Progress Report | Timely and sufficient TA is contracted |

| DESCRIPTION | VERIFIABLE INDICATORS | SOURCES OF VERIFICATION | CRITICAL ASSUMPTIONS |
|---|---|---|---|
| <p>Main Activities for Result 3:</p> <p>3.1 Consolidate VBOP Performance Reporting</p> | <p>Quarterly PMT reports consolidated by HO during Phase III Quarterly PMT reports submitted to PSC starting 31.03.2006 Reports include VBOP Outreach Map starting 30.06.2006</p> | <p>Quarterly consolidated reports by 31.3.06 PSC in receipt of Quarterly Reports Map included in Quarterly Reports</p> | <p>Timely TA is contracted.</p> |
| <p>3.2 Establish MPMU to consolidate Reporting for VWU project performance</p> | <p>VWU MF Performance Monitoring Unit (MPMU) established All VWU HO microfinance managers trained in PMT (Adjusted) PMT format adopted for all VWU HO Central level MF units records accounts monthly in the PMT VWU MPMU submits quarterly consolidated PMT reports to VWU leadership, donors, and Project Steering Committees</p> | <p>Unit established at VWU Training reports PMT reports available TVM, VBOP etc. report in PMT Overall MF performance reports available</p> | <p>VWU leadership ensures full cooperation from all VWU units, departments and projects.</p> |
| <p>3.3 Support Coherent NGO-Microfinance Performance Reporting</p> | <p># NGO microfinance projects registered with the MPMU # NGO microfinance projects adopting the PMT # NGO microfinance projects submitting quarterly PMT reports to the MPMU Performance Monitoring System agreed by the MFWG MPMU Quarterly MF Outreach and Performance Report disseminated</p> | <p>MPMU quarterly Progress Report MPMU quarterly PMT reports MFWG Bulletin MFMU Progress Reports</p> | <p>MFWG commits to PMT format adapted to Viet Nam.</p> |
| <p>3.4 Support Performance-based Dialogue for Enabling Environment</p> | <p># consultations with SBV and GoVN on the Decree and Regulations called or attended by the MPMU List of issues presented by microfinance projects to SBV # revisions in the Draft Decree effected by MFWG lobbying # revisions in the Regulations effected by MFWG lobbying Final Decree/Regulations acceptable to majority of MFWG # consultations with MF donors called/attended by the MPMU # donors adopting the PMT as required Reporting Format</p> | <p>MPMU Progress Reports Agendas and minutes of meetings Minutes of meetings, Draft Decree/ Regs. MFWG Bulletin MPMU Progress Reports Logos on PMT for Viet Nam</p> | <p>Main industry stakeholders agree on a suitable forum for dialogue.</p> |
| <p>3.5 Conduct Feasibility Study for Future VWU Role in Microfinance and support Strategic Business Planning Process in VWU</p> | <p>TOR for MF Feasibility Study consulted and agreed Feasibility Study conducted and conclusions approved Feasibility Study disseminated to all VBOP Province PMUs (and other Province VWUs) Action Plan for VWU Strategic Business Planning adopted Plan submitted for funding to Project Steering Committee- MoU on funding of Business Planning Process signed # studies, researches and TA provided under the MoU Strategic Business Plan with financial projections for the VWU adopted by VWU leadership by the end of Phase III.</p> | <p>Final TOR by 09/2007 Approved Study by 12/2007 Feasibility Study received by Prov. PMUs Action Plan adopted by VWU leadership PSC agenda/minutes MoU signed by 12/2006 Central PMU Progress Reports Strategic Business Plan by 06/2009</p> | <p>Timely and well qualified TA contracted. VWU leadership committed to Business Planning Process and takes the lead.</p> |

| DESCRIPTION | VERIFIABLE INDICATORS | MEANS OF VERIFICATION | CRITICAL ASSUMPTIONS |
|---|---|--|---|
| <p>Main Activities for Result 4:</p> <p>4.1 Produce Annual Work Plans w/ tranching budgets to be released based on performance</p> <p>4.2 Update Policies, Procedures, Manuals</p> <p>4.3 Implement and Monitor Project Progress</p> | <p>Annual Project Work Plans w/ targets and budget submitted for PSC approval each December</p> <p>Annual Implementation Plans with budgets and targets submitted by 17 Prov. PMUs to Central PMU</p> <p>Central PMU accounts recorded in MB general ledger</p> <p>VBCP Phase II audited by end December 2004</p> <p>Revised Management and Operational Manuals include financial management policies and procedures, end 05</p> <p>Central and Prov. PMUs accounts in PMT (and MB) financial statements by end 2005</p> <p>All Prov. PMUs report quarterly against targets by 03/2006</p> <p>Central PMU releases annual budgets based on performance</p> <p>PSC receives consolidated quarterly reports from HO</p> <p>PSC approves release of annual budget to Central PMU</p> <p>Annual VBCP workshops held to review/revise LFA</p> <p>Mid-term Review and Final Evaluation contracted on time</p> <p>Annual project and Credit Fund audits conducted</p> <p>Expenses diverge max. 10% from budget lines</p> | <p>Minutes of PSC meetings approving release of annual disbursements</p> <p>Province PIPs</p> <p>MB print-outs by 31.12.2004</p> <p>Audit report</p> <p>Manuals available in provinces end 2005</p> <p>Reports include HO accounts by end 05</p> <p>Narrative/Financial (PMT) reports</p> <p>Central PMU Financial progress report</p> <p>Minutes of PSC meetings</p> <p>Reports from workshops</p> <p>Contracts and reports</p> <p>Audit reports</p> <p>Financial Progress Report</p> | <p>Timely and sufficient TA is contracted</p> <p>Timely and sufficient TA is contracted</p> |

2. Background and Introduction

Viet Nam's recent past is a remarkably successful story of economic growth and transition. In the past 15 years, the formerly closed and state-dominated country with a significant food deficit has transformed into a mixed economy with a highly dynamic and quite competitive private sector that records the second highest annual growth rates in the world, and exports rice. Industry and construction accounts for 38% of the GDP, service for 37.8% and the agricultural sector (agriculture, fisheries and forestry) contributes 22% of GDP (2003). While the share of the state-owned sector in the GDP is still high (38% in 2003), the 'individual and private economy' is increasing, and the state now owns less than 3% of assets in agriculture¹. With a total population of 81 million growing rapidly and a high population density in many areas, Viet Nam has a large potential market for microfinance.

Belgium and Viet Nam have cooperated in the field of microfinance for six years. The project "Strengthening of the Institutional Capacity of the Vietnam Women's Union to manage Savings and Credit Program for rural Poor Women", called the "Vietnam-Belgium Credit Project" (VBCP) for short was started in December 1997 as a 3-year pilot intervention (later extended by 6 months) to support the provision of credit and savings services to rural poor women in one commune of each of 57 widely dispersed, rural and under-served districts in seven provinces of five different regions of Viet Nam. The project is implemented by the Viet Nam Women's Union (VWU).

A second phase of the Project was approved for the period of 01 December 2000 – 31 December 2004 at the value of 3.7 million Euro from Belgium and 1 million Euro equivalent in Vietnamese Dong (VND) from the Vietnamese Government and VWU. While the focus on VWU institutional capacity building remained during Phase II, the extension included a specific objective on effectiveness and viability (sustainability) and a significant expansion of activities: 100 new communes in 30 districts of 10 new rural and urban provinces adjacent to the pilot provinces were selected in addition to the more organic expansion into 50 new communes in the 7 pilot provinces. Phase II has been extended till end 2005.

Following a Mid-Term Review in November 2003, the Joint Commission on Development Cooperation between Viet Nam and Belgium agreed to extend its cooperation in the area of microfinance through a third and in all probability last phase of the VBCP of 3-4 years duration starting in January 2006.

An Identification Mission was contracted in October 2004 to analyze and verify the feasibility of the project objectives agreed by the Joint Commission in December 2003 in the rapidly evolving economic environment in Viet Nam, and to develop a project description and an outline of the Project Implementation Plan in accordance with the Logical Framework Approach (LFA). The Identification Team comprised two international microfinance experts and one national consultant. The assignment took place between October 25 and November 24, 2004. A draft report was submitted for comments, and the comments received have been incorporated in this report.

Throughout the assignment, the Consultants were fortunate to meet with committed professionals, who shared their insights and assessments of the current situation and constraints, and took time from a busy schedule to attend meetings and provide information and feedback. The Consultants would like to extend their sincere appreciation for all the time and effort that was put into the assignment by all persons met.

¹ Socialist republic of Vietnam: Policies and Measures to Strengthen Implementation of the 5-year Socio-Economic Development Plan (2001-2005), Hanoi, 2001 and State Bank of Viet Nam: Annual Report 2003.

3. Approach and Methodology

The Identification assignment consisted of three main components: an analysis of the political, economic and financial environment and the microfinance sector as it is emerging in Viet Nam; a brief review of the Viet Nam Belgian Credit Project (VBCP) implemented by the VWU; and the design of the Phase III of the VBCP in the logical framework (see Terms of Reference for the assignment in Annex 1).

In response to the TOR (Section 2, item 1-3), the analysis of the environment and the microfinance sector review utilized a financial systems approach, involving an assessment of the characteristics of the client market (ultimate beneficiaries) and the structure of demand for microfinance; of the existing microfinance retailers (including VWU as the intermediate beneficiary), of the financial and non-financial infrastructure for these retailers (e.g. training, TA, audit provision); and of the enabling environment at macro-level, including policies, legislation and regulation pertaining to or affecting the microfinance sector.

A review of existing publications, reports and other materials was conducted to gain an overall understanding of the sector. The Team reviewed the pertinent laws related to microfinance including the current draft Microfinance Decree. Several policy papers and reports, including the CRPSG, the annual reports from the SBV, WB, UNDP and ADB were also reviewed. At the level of the VBCP, the Team reviewed the identification, Formulation, and Annual Progress reports for Phase II, the Mid-term Evaluation, and various operational manuals, policies and the MIS.

Following structured interview guides developed by the Team, key stakeholders in the Ministry of Planning and Investment, the SBV, donor agencies, and state-owned and apex banks (VBARD, VBSP, CCF) were interviewed at central and Province levels. The Team met with officials from DGDC and BTC as well as leaders and key staff in the Central "Permanent Project Management Unit" and at the VWU in Hanoi, and held structured interviews with staff and management at Province, Districts and Commune level PPMUs as well as focus group discussions with center- and group leaders and members (clients) in the two Provinces of Kon Tum and Hung Yen. The work program of the Identification Mission is enclosed in Annex 2 and a detailed list of individuals met is presented in Annex 3.

Additional information on the market and microfinance clients was obtained from impact research studies, donor-funded project reports, the bulletins of the Microfinance Working Group and independent consultants. These interviews informed the analysis of stakeholders' interests, major problems and alternative strategies available, in response to the TOR (Section 2, item 4-5).

Reflecting the TOR (Section 2, para 6-10), the project design for Phase III was elaborated through a consultative and participatory process involving the key project stakeholders. At mid-course in the assignment, two workshops were conducted to present and solicit comments to the proposed general outline of Objectives and Results for Phase III from VWU leadership, VBCP management and staff at central, province and commune levels, and representatives of the DGDC, BTC, State Bank, and the TYM Fund managed by VWU at central level. The feedback was incorporated into the proposed design. Subsequent meetings with the donor agency and the central VBCP management unit were held to discuss the project in more detail. A meeting was held with the central PMU and VWU leadership at the end of the assignment to discuss the final design. An offer by the Identification Team to introduce the concepts of performance-based and results-oriented implementation using a standardized monitoring tool was declined. The draft report in its entirety was presented to the stakeholders on 24 November, and comments received have been incorporated in this Final Report.

The Report is divided into seven sections. Sections one through three present the executive summary, background, and methodology. Section four presents the political, economic, legislative

and regulatory environment in Viet Nam. Section five covers the findings of the Identification Team related to clients and the market, the microfinance providers, their support service providers, and their donors. Section six presents the rationale for the revised approach recommended for Phase III. Section seven describes the recommended design for Phase III in the Logical Framework (LFA) including its components, indicators for performance measurements, assumptions made, and the recommended management structure and indicative costs. Annexes to this report provide additional rationale for the proposed activities, an indicative budget, as well as the Draft TOR for the Formulation Mission (TOR Section 2, item 11), which the Identification Team recommends should include an appraisal of the design (See Annex 10).

4. The Setting for Microfinance in Vietnam

Viet Nam's development over the past 15 years represents one of the most successful economic transition and growth ventures in the world, its economic dynamism matched only by neighboring China. Since the early 1990s, a series of macroeconomic and structural reforms have been implemented to transform the formerly closed economy into a mixed and market-oriented economy, and to combat poverty in the process.

A key factor has been the rapid modernization of the economy. Resources have been transferred from low productivity primary sectors (agriculture), to the higher productivity secondary and tertiary sectors. While agricultural growth used to be the main driver for reducing poverty, job creation in the private sector has become an increasingly important factor. In 2003 alone, more than 30,000 private enterprises applied for a business license.

In spite of the general global economy slowdown, Viet Nam has thus displayed one of the fastest growing economies in the world over the past 4-5 years, with GDP increasing by 7.2% in 2003. This has been supported by an impressive export growth of 21% in value terms, with exports to the USA increasing by close to 60%. GDP per capita is set at USD 480 in 2003. For 2004, the Government of Viet Nam (GoVN) expects a GDP growth of around 8%.

The political underpinning of the market economy appears to be steadily increasing. When seen over a 5 year period, the building of political momentum for market liberalization is evident. Government officials are increasingly vocal in their support for the private sector, and the risk of reversals due to political changes appears increasingly unlikely². The political support for change was achieved by ensuring broad-based consensus and strong government commitment throughout the preparation of the Comprehensive Poverty Reduction and Growth Strategy (CPRGS), which builds on Vietnam's 10-Year Socio-Economic Development Plan 2001-2010.

The CPRGS was approved by the Prime Minister in May 2002, and accepted by the World Bank in July the same year as the basis for a Poverty Reduction Strategy Credit. The targets of the CPRGS are in line with Viet Nam's Millennium Development Goals for 2010, namely to reduce by 40% the proportion of people living below the internationally accepted poverty line, and to reduce by 75% the proportion of people living below the food poverty line, as compared to 2000.

There is no particular policy for microfinance in Viet Nam, but financial services are seen as an important tool for reducing poverty. Central components of the CPRGS address the need to:

- Developing credit as a means to finance production and technological change;
- Promoting deposits to better enable poor to accumulate savings for investment and provide a cushion against seasonal shortfalls and unforeseen crisis.

² "Implementation Completion Report: Second Poverty Reduction Support Credit", The World Bank, June 2004.

The CPRGS complements and strengthens the national Hunger Eradication and Poverty Reduction Plan (HEPR), which was formally established in 1998 as a nationwide framework for integrating poverty reduction efforts targeted at poor households and poor communes.

4.1 The Vietnamese Financial System and Banking Sector

Supervised by the State Bank of Viet Nam (SBV), which has branches in all 64 Provinces of the country, the banking sector is dominated by four main State-Owned Commercial Banks (SOCBs) that account for about 70% of total assets. In addition, the formal financial sector comprises 37 Joint Stock Banks (JSBs), 4 Joint Venture Banks (JVBs), 27 representative offices of foreign banks, close to 900 regulated credit cooperatives, 5 financing companies, and 8 leasing companies³.

With the macroeconomic reforms, the financial sector has undergone substantial changes since the early 1990s, with improvements both in structure, in regulations and in operations⁴.

One key area of focus is the ongoing adjustment of the SOCBs from specialized policy lending vehicles to more commercially sound banks. GoVN is implementing a multi-year restructuring and recapitalization program with support from the International Monetary Fund and the World Bank (WB) to assist the SOCBs that are still struggling with the legacy from decades of policy lending, namely a substantial level of Non-Performing Loans primarily to State Owned Enterprises (SOEs). Many of the SOEs are defunct and will never be able to service their obligations.

By September 2003, nearly 60 percent of the Non-Performing Loans officially identified in 2000 had been resolved. The affected banks have also received capital injections of about VND 7.7 trillion, out of a total planned injection of VND 10.9 trillion. However, the current capital adequacy ratio of the banks (under 4 percent) is still low by generally accepted standards⁵.

Another important reform measure is the gradual deregulation of the interest rate regime, but this has not yet led to major movements in the rates. Rapid growth in monetization, reluctance to compete on interest rates, and occasional indirect SBV intervention are all possible explanation factors. Most banks seem to follow the rates set by the dominant SOCBs in the market.

This may be a serious challenge for the financial sector in the longer run with repercussions also for microfinance. As noted by the WB (see text box), a continuation of this practice will limit and constrain the development of sound microfinance operations, as these normally require even higher interest rates to cover their real costs.

WB Banking Sector Review (para 144):

"SOCBs explain this inelasticity [of interest rates] as a fear of competition and a perceived duty to advance their clients' business prospects through providing good rates. This could imply quite an unusual type of pricing by the large SOCBs maintaining the lending rates at concessional levels despite their own interest margins possibly being insufficient to cover both their cost, credit risk and asset growth. In the short term, this inelasticity may appear to be beneficial to the SOCBs and borrowers, in the medium- to longer-term this could hurt the viability of the JSBs and potentially harm the development of a market-oriented and competitive financial sector. It is conceivable that the banks may today be pricing only to cover the direct cost of operations, with no allowance for true cost of capital, provisioning for credit risk or for building capital base for future growth."

³ State Bank of Viet Nam: 2003 Annual Report.

⁴ Vietnam Banking Sector Review, World Bank, 2002.

⁵ East Asia Update, Regional Overview April 2004, World Bank.

4.2 The Policies, Legal and Regulatory Framework

The general financial legal and regulatory framework was thoroughly overhauled in the mid-1990s, and the reform process is directed at adopting international standards, and instituting legislation that will facilitate Vietnam's eventual accession to the World Trade Organization.

The current laws which impact microfinance are the "*Law on Credit Institutions*" and the "*Law on the State Bank*" from 1997, which regulate formal banking institutions. These have been amended and elaborated, latest with the "*Law on Amendment of and Addition to a Number of Articles of the Law on Credit Institutions*" from June 2004. In addition, the "*Law on Cooperatives*" from 1996 regulates credit cooperatives, the Decree "*On credit for the poor and other policy clients*" from 2002 supports the foundation of the Vietnam Bank for Social Policy (VBSP), and the "*Civil Law*" from 1995 has at least an indirect impact on the operations of semi-formal and NGO programs.

The State Bank of Viet Nam supervises the regulated financial institutions through its branch network. On and off-site inspection takes place, and even the small credit cooperatives are relatively effectively supervised and rated. In 2003, more than 90% of the People's Credit Funds were rated as class A and B, and several licenses have been revoked as a response to non-performance.

Viet Nam lacks a sound policy framework for microfinance activities. Good practice in this respect does not generally imply a strict regulatory regime, but rather a basic legal foundation, facilitating the transformation of semi-formal NGO schemes into commercially legitimate microfinance institutions. The lack of a proper legal framework has been cited as a major reason for the limited scale and outreach of semi-formal microfinance in Viet Nam.

While the SBV has engaged in the process of developing a legal framework for sustainable microfinance, the pressure for an enabling legislation appears to be coming more from international donors, than from the national stakeholders that could be affected by it, i.e. the Mass Organizations (MOs), including VWU⁶. This reluctance reflects the current perception of microfinance as a particular poverty reduction instrument, different from the normal workings of the financial sector. The VWU has been issued an official letter by the Prime Minister allowing it to continue savings and credit activities to reduce poverty, and the Decree on the Viet Nam Bank for Social Policies (VBSP) regulates its scope of providing loans at highly subsidized interest rates to those that are defined as poor.

While eagerly awaited, it is doubtful that any future legislation will be able to provide the necessary foundation for further expansion of microfinance, as long as this basic premise for sustainable microfinance remains contentious among the key stakeholders in Viet Nam. The current uncertainty and immaturity of the microfinance market is in many respects only a reflection of larger financial sector concerns and challenges in the transition to a liberalized market economy.

4.2.1 Microfinance Regulations: The Draft Microfinance Decree

After three years of discussion supported by substantial Technical Assistance (TA) from the Asian Development Bank (ADB), a Decree on the "*Organization and Operation of Microfinance Institutions*" in Vietnam is now apparently close to finalization. The stated intention of the GoVN is to have a final Decree adopted by the end of 2004, but this is subject to GoVN

⁶ Interview with Mrs. Hop, SBV, in Vietnam Microfinance Bulletin, Issue 5 August 2005.

reaching internal consensus. Involved stakeholders include the SBV, the MOs, and the ministries primarily of Justice and Finance.

On the positive side, the Decree introduces a legal foundation for future microfinance activities, and provides legal legitimacy to MFIs. It will contribute to greater transparency in the sector and to more specialized operations. It includes most normally accepted provisions for microfinance legislation, especially with regard to safeguarding deposits received by intermediating MFIs. The draft Decree splits MFIs in two types of regulated institutions:

- MFIs not permitted to take voluntary savings, required to have a legal capital of VND 500 million (about USD 30,000), and
- MFIs permitted to mobilize voluntary savings, required to raise a minimum legal capital of VND 5 billion (about USD 300,000).

On the other hand, ADB's TA to the process⁷ indicates that the drafting of the Decree has not been without challenges. The latest draft dated October 2004 still reflects the key issue of ownership caught between the charity-orientation of national stakeholders, and the need for commercial clarity of a financial institution:

- The draft Decree does not allow private entities to establish MFIs; only MOs and Vietnamese (non-profit) NGOs can own licensed MFIs, which must be legal entities with a Business Certificate and a separate governance structure. Other Vietnamese and foreign organizations may contribute capital. The reason for this fundamental limitation in the Decree is not clear, as none of the MOs appear very intent on transforming themselves into MFIs.

Unless resolved, this will impede financial sector deepening, as opening markets to privately-owned entities normally encourages capital flows that may now not be forthcoming. Microfinance is apparently still seen as a social activity, where the forces of markets need to be constricted.

Additional important concerns with the latest draft of the Decree include the following:

- The Decree makes no allowances for the continuation of credit and savings at any scale unless the activity is licensed, implying that all microfinance in Viet Nam could in principle be subject to licensing under the Decree. In most countries, small and localized, member-based savings and credit operations are exempted from formal licensing, as they represent limited systemic risk, and as the capacity of any central bank to supervise all such schemes is constrained.
- Normally, there is no need for a very strict capital requirement for non-deposit taking MFIs, as there is no systemic risk. Taking into account the limitations in ownership, the capital requirements will be difficult to meet for small schemes in resource poor areas with limited capital availability, and may hinder the pioneering of new methodologies;
- The draft Decree leaves a number of issues to be determined in more detail through guidelines and follow up regulations to be developed. This includes for instance required accounting systems and reporting obligations. The Ministry of Finance and the State Bank of Vietnam are responsible for providing these guidelines. As always with legislation and regulations, the devil is in the detail.

⁷ "Preparing the Framework for Microfinance Development", PWC & Enterplan, Revised Draft Final Report, September 2004.

- In the draft Decree, current activities are given 24 months to “process an application for license”. How the WU and the other MOs intend to transfer at least the larger savings and credit activities sponsored by donors and themselves into one or more MFIs in only two years is a critical question with few obvious answers.

Most current microfinance schemes – including VBCP – delivered through the MOs are thoroughly mixed with other activities of the MOs, particularly at local and provincial levels. Staff has multiple responsibilities and few if any local MO offices are geared to delivering financial services. In many provinces, MO staff run several MF programs with different methodologies and different donors, in addition to linking members to formal banks. Separating, clarifying roles, organizing and structuring the many microfinance efforts of the MOs into dedicated and well run MFIs that cover their costs is clearly a challenge – doing this in two years is next to impossible.

If the Decree takes effect as planned from the beginning of the 2005, the few specialized microfinance operations run by MOs and NGOs that currently cover at least operational costs can start planning for transformation with a view to apply for an MFI license.

All those schemes that have scant possibilities for reaching at least operational cost recovery will, if the current Draft Decree is to be taken literally, not be allowed to continue operations after the end of 2006, unless they can find a sponsor to cover their likely deficits. There must be very, very good reasons for an external donor to take such a position. These schemes, including the VBCP, will therefore have to think hard about their future.

5. The Microfinance Sector in Viet Nam

5.1 The Clients: Current Market Characteristics and Demand

The population of Viet Nam is approximately 82 million, increasing at 1.2% per year. In Viet Nam in general, access to education, health and participation by the population in the labor force is considerably higher than in countries at a similar level of development. While the pace of urbanization in the main city centers of Ho Chi Minh City, Da Nang and Ha Noi is fast, urban areas account for only 24% of the total workforce. Urban unemployment is about 6%⁸.

Some 12 million of the estimated 15 million households in Vietnam reside in rural areas, 9.6 million of them on farms. They make up 76% of the Vietnamese work force. About 7.8% of rural households are landless.

According to the Ministry of Labor, Invalids and Social Affairs (MOLISA), poverty has decreased dramatically to 13% in 2002, against 37.4% in 1992. The drop is confirmed by the Vietnam Development Report 2004, which, however, states that 28.9% of the population lived below the poverty line in 2002, down from 37.4% in 1998.

It is estimated that about 5.4 million rural households are low-income households (LIHs) with a per capita income of less than USD 128⁹. Poverty is substantially higher in rural areas (35.6% below the poverty line) than in the urban centers (6.6%)¹⁰, and is increasingly concentrated in areas with large ethnic minority populations (poverty rates of up to 69.3%). Compounding the problem is that these areas tend to be under-developed in terms of infrastructure and links to local and national markets.

⁸ State Bank of Viet Nam: Annual Report 2003.

⁹ "Draft Final Report: Preparing the Framework for Microfinance Development", ADB and SBV, Sept. 2004.

¹⁰ Vietnam Development Report 2004.

Because the vast majority of the poor population lives in rural areas, the microfinance market in Viet Nam has traditionally been interpreted as the market for financial services for rural households. While global microfinance also serves urban poor, most microfinance in Viet Nam is provided in areas defined as rural¹¹.

Like everywhere else, the Vietnamese poor face constraints in accessing financial services, including lack of sufficient collateral for loans, and lack of means to service loans according to the banks' preferred schedule (payment of principal at the end of the loan). In addition, not all remote communes have access to formal banking services, and the poorest lack the confidence to confront a bank, have limited production potential, or are outright destitute.

Unlike most other countries, however, the market penetration of formal financial services providers in Viet Nam is remarkable. Formal sector bank credit has increased as a proportion of GDP from 27% in 1995 to 44% in 2000 and of this, credit to the private sector has increased from 18 percent in 1992 to about 60 percent in September 2002¹². Indeed, most low-income households have access to some form of credit, and the formal banking system seems to reach a substantial number of them, with the AgriBank (Viet Nam Bank for Agriculture and Rural Development – VBARD) and VBSP together estimated to serve approximately 9.8 million clients at the end of 2003.

For most microfinance clients, access to credit is no longer as much of an issue as is getting a loan that properly suits their needs. The rapid expansion of the formal financial system deep into the rural areas, and reports from NGO projects in the field all indicate an increasingly sophisticated demand for higher and differently structured loans.

Rather than traditional outreach, the challenge for successful microfinance in Viet Nam is thus the provision of well adapted services to increasingly narrow niche markets of poor entrepreneurs in more remote areas, and especially for ethnic minorities, as well as the retention of clients in more accessible areas in direct competition with increasingly commercial banks.

5.2 The Microfinance Providers

5.2.1 Formal Financial Institutions

The Vietnamese microfinance market is characterized by the dominance in scale and depth of formal sector providers, namely the Vietnam Bank for Agriculture and Rural Development (VBARD), the Vietnam Bank for Social Policy (VBSP) and the plethora of People's Credit Funds (PCF) having re-emerged as regulated savings and credit cooperatives all over the country after the collapse of the old cooperative system in the 1980s.

Rural Shareholding Banks (RSHBs) are remnants of the former rural credit cooperatives, but continue to run localized lending operations in some areas reaching an estimated 10-12,000 clients. According to some sources, they tend to prefer less risky clients than the poor¹³. Borrowers are reported to appreciate the RSHB accessibility and the fast and simple procedures, but the typical RSHB has limited capacity due to constraints in capital resources and savings mobilization.

¹¹ Exceptions include the CEP Fund that operates exclusively in the HCMC area, and the SCF-US supported microfinance service company recently established in Ha Noi.

¹² Vietnam Development Report 2003, World Bank.

¹³ "Project Evaluation and Programming Recommendations" The Vietnam-Canada Rural Finance Project, 2000.

Mandated to serve the rural financial market, *VBARD* is a state-owned commercial bank and the largest bank in Viet Nam. It has a nationwide network of 1,800 branches covering 563 districts in all of the 64 provinces. In some areas, *VBARD* also operates mobile banks. *VBARD* is the largest provider of the full range of microfinance services (savings, credit, money transfer etc.) in Viet Nam, with an estimated VND 70,320 bn (USD 4.6 bn) outstanding to about 7 million borrowers as at end 2003, 70% of whom are rural. 80% of its portfolio is deposits mobilized from the public.

VBSP, initially called the Vietnam Bank for the Poor, used to operate through *VBARD* facilities, but was reconstituted in 2002 with its own branch network of LPC-subsidized offices in 587 districts of the country. The *VBSP* is the prime vehicle for GoVN to channel subsidized credit for policy purposes, and is thus fully guaranteed by the Government, is exempt from taxes, state budget remittances, and the deposit insurance scheme. It has taken over preferential lending schemes from MPI, MOLISA, People's Committees at all levels, and from the SOCBs. *VBSP* mobilizes an increasing amount of capital for lending, including deposits from the public, donor funds (IFAD, OPEC) and a mandatory contribution of 2% of the deposits of the State Owned Commercial Banks. By end 2003, *VBSP* had VND 10.3 billion in loans outstanding, 80% of which were provided to some 2.8 million poor households at an average loan size of VND 3.6 million.

People's Credit Funds are community-based financial cooperatives that are owned, operated and governed by shareholding members, modeled after Desjardins. PCFs are licensed under the Cooperative Law and supervised by the SBV on their adherence to set standards regarding financial management, member capacity, economic activity in the area, etc. An initial share contribution of VND 50,000 makes members eligible to save and take individual loans. Interest rates vary, with some PCFs charging up to 1.5% per month. Currently, some 900 PCFs cover about 1,000 communes in 53 provinces. Their total outstanding loan balance at the end of 2003 was VND 4,050 bn, to 663,753 individual members. Total membership is over 911,000, out of which some 35% are women. Savings mobilized as at end 2003 totaled VND 3,208 billion, providing some 70% of loan funds. Average loan size is VND 6.1 million.

Acting as an apex in the PCF network, the *Central Credit Fund* (CCF – proposed to change to The Cooperative Bank) attracts and mobilizes capital from shareholders (the PCFs and the 4 SOCBs), donors and public deposits, serves commercial and urban customers from its 54 branches, and supervises and intermediates funds to the local PCFs. Like *VBARD* and *BVSP*, the CCF is regulated by the Credit Institution Law, and supervised by the State Bank of Viet Nam.

All three main providers pursue the market for small, rural loans aggressively. *VBARD*'s lending conditions have become more flexible and do target LIHs, if not the poorest segment: the average loan size is around VND 6.45 million. Repayments tend to be in yearly installments or as balloon payments at the end of the loan term, which is not well suited to the typical petty trade enterprise of many microfinance clients, but may well suit seasonal crop producers. Loans below VND 20 million are formally collateral-free, but in practice borrowers must often leave their Land Use Certificate (LUC) with the bank until the loan is repaid. A large number of especially poor households do not have an LUC. The basic interest rate of *VBARD* appears to be nudging upwards, and is now 0.9-1.1% per month for short-term loans.

VBARD refers the poorest of their clients to the *VBSP*. *VBSP* concentrates its subsidized lending to small businesses in remote areas, and to households identified as poor by the LPC (using criteria developed by MOLISA). It charges 0.5% interest rate on loans up to a maximum of VND 7 million. Loans are without collateral, but borrowers are normally asked to

form groups. Several reports indicate that also better off people get access to these loans, as the practical interpretation of the poverty criteria may differ from commune to commune.

Both VBARD and VBSP have signed Framework Agreements with MOs, including VWU in many areas that has made it easier for many poor to access the bank. MOs organize their (poorer) members in groups, provide crucial legitimacy in the loan application process, and act as informal guarantors for the clients. The group leader assists in the loan transactions, for which the MO and the group leader receives a small commission. The loan documents are signed with the borrower as an individual. This linkage system has clear advantages for all parties. The banks gets easy access to mobilized borrowers that repay, the MOs retain their members, and the more enterprising MO members that want to expand and grow their businesses get access to the full range of banking services, including increasing loans.

All three formal providers have significant expansion plans for the near future. VBARD intends to increase its outreach further by establishing more Inter-Communal branches that ease access for customers in more remote areas. The bank expresses a desire to improve and expand in rural areas, and emphasizes increased flexibility at lower levels of the bank to achieve this¹⁴. VBARD will in all likelihood remain the main formal provider of microfinance services in the short to medium term in Vietnam, and represents the currently most proficient formal financial institution for the VBCP clients.

VBSP is not covering its operational costs and relies heavily on the Government for covering losses. As a non-sustainable operation that undercuts all competitors in the market, including VBARD and any MFI to be established under the Decree being drafted, it represents the largest distortion and threat in the current microfinance market. Its basic assumption that the poor are not able to afford market interest rates has been proven consistently wrong everywhere in the world. Permanent access to sustainable financial services that are provided reliably has proven to be more important than low interest rates provided by unsustainable institutions. There is no reason why Vietnam should be different.

However, VBSP is likely to stay in the immediate future, increasing and expanding operations. As cautiously suggested by the current management, there is perhaps a vague hope that the VBSP may gradually start to align their interest to market rates, thus reducing both the level of distortion and the drain on government budgets. With the current client base this would indeed make VBSP a core player in the microfinance market.

Reportedly, the services of the PCFs are in high demand due to simple and quick loan and savings procedures and closeness to the clients. The PCF/CCF network is possibly one of the most sustainable financial institutions currently active in Viet Nam.

5.2.2 Semi-Formal Providers

Semi-formal microfinance is provided primarily through the *Mass Organizations* and NGOs, most supported by international NGOs. The Women's Union, the Farmers Union and the Youth Union with a combined membership of about 20 million all manage group loan and savings schemes, implement INGO-supported microfinance projects and link clients to VBARD and VBSP.

The VWU has been the chosen collaborator for many INGOs due to its effective outreach at the grassroots level, and is currently implementing some 40 savings and credit schemes. Of these, the VBCP project with 51,300 active borrowers and the TYM Fund with 19,462

¹⁴ "Draft Final Report: Preparing the Framework for Microfinance Development", ADB and SBV, Sept. 2004

borrowers and a combined outstanding loan balance of VND 75.1 billion (Sept. 2004) are the largest. The VWU has no specific financial implementation units, but has integrated the savings and credit operations with other (primarily social) activities, employing its existing staff and organizational structure in a flexible manner.

Currently, some 55-60 (I)NGOs implement microfinance programs in Vietnam, most in collaboration with the VWU, not least due to the uncertainties related to the legal framework for microfinance. Programs are generally small and geographically scattered; many operate in a few communes within one district only¹⁵. Few INGOs contribute with substantial capital, and this decidedly limits outreach, particularly as the financial sustainability of many efforts appears low.

A number of figures exists regarding the outreach of these programs, ranging upwards to one million loans¹⁶, but such large numbers stem from the reporting of accumulated impact rather than current client outreach. The Vietnam Microfinance Bulletin published by the commendable INGO-initiated Microfinance Working Group counts 47,452 borrowing clients reached by 13 programs as at September 2004, with a total outstanding loan balance of VND 28.4 billion (USD 1.8 million), and VND 6.7 billion (USD 427,000) in mobilized (and typically intermediated) savings¹⁷.

Most INGO-supported programs use a solidarity-group methodology, either of the village bank or Grameen type. Only the CEP Fund and the newly established SCF-US supported program in Ha Noi provide individual loans. CECI supports small rural credit cooperatives, which also provide individual loans. Interest rates range between 0.8 – 1.7% per month, calculated on a declining balance (a few take flat rates). Loan sizes range from VND 100,000 – 6 million, the most common being VND 1.5 million. About half the INGO-programs offer voluntary savings, and almost all offer interest on savings, ranging from 0.2-2% per month. The majority of the schemes offer financial services as part of an integrated package of other activities¹⁸.

In total, the semi-formal market may reach in the vicinity of 120,000 clients at present, and offer small loans and savings services well adapted to the poor, but less suitable for entrepreneurial clients needing larger loans. While the delivery mechanisms are clearly more geared to reach the poorer clients, there are few products in the semi-formal market that departs markedly from what is available through the formal financial channels. There is a degree of systemic risk in the semi-formal market, as a substantial amount of deposits mobilized from the poor are intermediated as loans, but repayment rates of all microfinance providers – formal and semi-formal alike - appear excellent (94-99%).

5.2.3 Informal Microfinance Providers

There is a long tradition of informal Rotating Savings and Credit Associations (ROSCAs) in Vietnam. These groups are referred to as Ho in the North and Hui in the South. Periodic saving contributions from members are rotated among a limited group of persons within a Ho/Hui. Normally members come from the same village, and membership averages 10-15 persons. Interest rates, membership and loan amounts are decided on either jointly, by a bidding process or by the organizer. The life cycle of a ROSCA ends when every participant has had at least one loan.

¹⁵ "Non-Governmental Organisations' Microfinance Programmes in Vietnam", SC-JV and JBIC, Oct. 2003.

¹⁶ "Current Status of the Microfinance Industry in Vietnam", Ministry of Foreign Affairs of Finland, April 2004.

¹⁷ NGO MFI Database compiled by the Microfinance Working Group, September 2004. See Annex 4.

¹⁸ "Draft Final Report: Preparing the Framework for Microfinance Development", ADB and SBV, Sept. 2004.

As in most other developing countries, *money lenders* continue to be an important source of informal credit in Vietnam. By nature, the money lender tends to be the richer people in the communities, who provide character-based short-term credit at high interest rates (around 4% per month). Interestingly, there are reports that money lenders have started to reduce their lending rates as a consequence of the increasing outreach of VBCP and VBARD.

5.3 Support Service Providers

The market for microfinance support services (training, technical assistance, capital for on-lending, audit etc.) in Viet Nam appears even less developed than the microfinance market itself.

Interestingly, VBARD provides training to clients and e.g. Women's Union staff in basic financial and banking skills and some INGOs also offer training and institutional capacity building as part of their projects. Very few national consultancy companies seem to have specialized in microfinance, and the few national consultants available are thus used by almost all providers (and donors), to the extent that external TA is solicited at all. The Center for Rural Progress in Ha Noi has been used by some providers. The Microfinance Resource Center at the Ha Noi National Economics University was renamed in 2003 to the Resource Center for Banking and Finance, and now focuses more on formal banking.

Most of the international auditing and management consultancy firms are represented in Viet Nam, and they are to a certain degree involved in the sector; PWC has been contracted to draft a manual for internal audit in the VBCP, while KPMG has offered financial management training and has recently been contracted for a project audit.

NGOs are not currently allowed to borrow commercially. For licensed MFIs, the draft Microfinance Decree proposed to rectify this constraint in the system.

5.4 The Funders

The GoVN is the main funder of microfinance through VBARD, the MOs and especially VBSP. The high level of state subsidies to the market continues to threaten the sector sustainability in the near future.

The World Bank, EU and Asian Development Bank are the key external funders to the reform processes in the overall financial sector, while also several bilateral donors have funded TA to the State Bank for the restructuring process. The EU, JBIC and KfW are involved in SME-finance support. ADB is the main donor in the microfinance industry development, and has funded the ongoing restructuring of VBARD, projects of the CCF, as well as the development of the legal framework for microfinance by the State Bank of Viet Nam.

Several multi- and bilateral donors have credit components embedded in broader 'rural development' projects, including AusAid and IFAD, while DFID and JBIC have funded studies and research on microfinance. CIDA has funded the establishment and development of CCF/PCF network.

In terms of support to direct microfinance provision, the key funders are the international INGOs, CARD Bank of the Philippines (TA provider to TYM), and DGDC through BTC (VBCP) as the only bilateral donor agency.

A comprehensive matrix of donor-funded projects in the financial sector has been developed, but donor coordination does not appear to have been developed further than that, e.g. to include a policy guideline for support to the microfinance industry, which could direct donor agencies to gaps and constraints in the market and ensure support based on Good Practice.

5.5 Conclusions: The Setting for the VBCP

The microfinance sector is not well defined in Vietnam, neither at the policy-level, the demand nor the supply side, reflecting a somewhat immature market.

- The focus of the SBV and the main donors has so far been squarely on reforming the financial system at large. The challenges and issues of micro-finance have yet to attract significant attention, and the Government lacks a clear long term strategy for sustainable microfinance;
- There is still a widespread tendency to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be fed by subsidies. This social approach is clearly visible in Government policies to the sector, introducing two particular distortions:
 - An interest rate policy through the SOCBs that implicitly limits the possibility of MFIs to determine rates that can cover costs;
 - The existence of the Vietnam Bank for Social Policy (VBSP) that charges half the interest rates of VBARD and that is guaranteed by the GoVN. VBSP can potentially ruin local credit discipline, while under-cutting sustainable microfinance providers.

Rich and poor people alike need continued access to financial services that are not restricted in time and scope. This can only be provided by permanent, sustainable institutions that are driven by the demand of their clients. Until the GoVN begins to treat microfinance as a financial market segment in the overall financial system, it will be difficult to establish financially sound microfinance operations;

- The upcoming Microfinance Decree may provide the needed legal basis for semi-formal microfinance, but there may not as of yet be the necessary consensus on the role of microfinance in the financial system. It is possible that the full formulation and the implementation of microfinance regulations under the Decree may take time, be unevenly executed, and may not in the short term provide the desired level of legal legitimacy and operational independence that sustainable microfinance needs in order to offer a serious alternative to the state banks;
- Like the other MOs, VWU's position seems to be that it does not aim to become a specialized microfinance institution per se. This implies that their current microfinance projects will have to be constituted as one or several separate legal and financially sustainable entities, or simply spun off (divested). It may be possible to break the microfinance schemes, including the VBCP, up into smaller profitable units, but whether this is an effective and efficient addition to the Vietnamese MFI sector is doubtful. Unless exemptions (thresholds) are provided for small schemes, it is unlikely that the current intermediation of deposits from members will be legal under the Decree.
- Contrary to most other countries, formal financial institutions in Viet Nam play a dominant role in provision of microfinance services, and reach deep and wide into the poorer segment of the population, often applying sound linkage methodologies like the Framework Agreements with the MOs. SOCBs and PCF seem to have a genuine drive to serve the rural market even with the very limited (possibly negative) financial margins that

the current deposit and lending rates allow, and offer services that to a large extent are adapted to the needs of e.g. the VBCP target group;

- The specific demand for small loans among the poor is not well analyzed. The rapid and dynamic economic development results in changing demand structures, which are not well recognized among the majority of providers. As a consequence, especially semi-formal microfinance services are not very market-responsive. There is ample scope to improve procedures and diversify products, but any innovative MFI will find it hard to keep costs within the squeezed financial margins of the market;
- In spite of this, the Vietnamese microfinance market displays an apparent strong credit discipline among poor people to service and repay loans. Most providers report repayment rates of 95-98% or better;
- Among the semi-formal providers, few have microfinance as their exclusive focus, and the level of Good Practice knowledge and adherence is not high. There is a general lack of technical microfinance skills and knowledge, in particular related to governance, institution building, business development and financial management;
- Semi-formal service provision is fragmented and coordination among the many stakeholders is limited. The overall outreach and performance of the segment is largely unknown. The recent initiative of the Microfinance Working Group to compile outreach and compare methodologies is a good starting point for enhanced coordination and Good Practice compliance.

In sum, the Vietnamese microfinance market leaves little room for providers that may be historically or structurally disadvantaged by diluted focus, scattered outreach, and limited skill. With the competition and the limited financial margins, only the most professional and efficient operations that focus on the under-served remote areas of the country are likely to succeed in the longer term.

6. The Vietnamese-Belgian Credit Project – Rationale for Phase III

Based on the analysis of the market for microfinance in Viet Nam and the experiences of the VBCP during Phase I-II, this section recommends adjustments and clarifications to the rationale for continued project support in Phase III in order to ensure the long-term impact that the investment over the past seven years demands.

The section does not attempt to provide a full review of the VBCP, but summarizes the lessons learned and the current constraints, which has informed the choice of strategy for the recommended design for Phase III.

6.1 Focused Targeting of the Poor

The planned and thus well-documented economy of Vietnam greatly facilitates the identification of the target group for microfinance being economically active poor households. Households are classified by level of poverty in geographic areas graded as more or less developed, accessible and urbanized¹⁹.

¹⁹ E.g. Poverty Mapping and Market Access in Vietnam: Inter-ministerial Poverty Mapping Task Force, October 2003.

Unlike the VBSP, whose clients must be officially registered by the Local People's Committees as poor, the VBCP clients must be poor as per the assessment of the Commune VWU and their reported income level is registered at start. Mobilization of the very ("hungry") poor into groups has been a challenge, partly because VWU membership also represents a resource that has been out of reach of many poor women. Consequently, it is estimated by VBCP staff that only some 40-60% of all clients reached so far are in fact poor.

With the self-selection mechanism embedded in small-sized loans, there should be little risk of mission drift (serving the non-poor), as long as selected communes are among the poorest. This rationale was applied in the selection of project areas for the VBCP Pilot Phase. The decision to expand the project area significantly in during Phase II should, however, have been based on a more solid analysis of the market. Some 75 of the additional 150 communes selected display a poverty rate above the national average, and several of the current VBCP Provinces now report poverty levels of only 5-7% of households (e.g. Hung Yen) – in such areas it is not evident that a poverty focused project like the VBCP is still needed.

In order for the project to meet its overall objective of poverty reduction during Phase III, the VBCP should focus exclusively on reaching women from poor households as per the official LPC lists – whether members of the VWU or not. Priority should be given to poor women from the most remote and rural communities in the current project areas, furthest from formal bank outlets. It would be commendable if the VBCP could achieve some market penetration into communities of ethnic minorities, who are clearly the segment of the population most adversely affected by poverty.

The goal and purpose as adjusted for VBCP Phase III and Result 1 (see section 7) aim at strengthening the targeting to this under-served segment of the population.

6.2 Demand-based Access to Services

So far, the VBCP has been supply-driven in its approach rather than oriented towards the changing market needs, and this should now change.

VWU members – and the poor in general - demand access to both business development services and financial services. Access to these services through solidarity groups has proven an effective approach, which also promotes empowerment objectives. Group mobilization and basic training has been successful during the VBCP Phase II, and should be continued.

With the increased outreach of VBARD and VBSP, and based on the demand for larger loans, a significant number (estimated at 25-30%) of VBCP clients have already accessed loans from the banks, most under Framework Agreements between the banks and VWU. This is an excellent linkage function that should be strengthened in Phase III. All experienced clients that demand larger loans should thus be linked to specialized credit and savings providers, including VBARD, VBSP, PCFs and any new MFIs emerging under the Decree.

The existing VBCP credit funds should remain at Province and Commune levels and be reserved for on-lending to the poorest and least experienced of the current clients, as well as for new poor women mobilized in the current project area. As a consequence, no further funds should be provided for loan capital during Phase III.

During phase III, the 'incubation' process for poor clients should be time-bound to a maximum of 36 months, and lending should be done in cycles that will develop the confidence and ability of all clients to effectively access credit from specialized providers at the end of the project. During the

last 6 months of the Project, Provinces should propose ways of divesting their portfolio at the end of the Project, and present suggestions for usage of the credit fund.

Based on client demand, the solidarity groups should be the platform for access by all clients to training and business development services, and could serve also as the linkage point for access to social services offered by other projects.

The Activities proposed under Result 1 and 2 (see section 7) aim to strengthen the system of mobilization, incubation and linkages to ensure that clients access the services they demand.

6.3 Results-orientation and Performance-based Monitoring

The Logical Framework-based Project Design Document for Phase II comprises an overall Goal supported by two Purposes (Specific Objectives). Surprisingly, no verifiable indicators have been developed at Purpose level, and the critical Assumptions stated at this level have not been monitored. The annual project reports describe progress against the activities under the (Intermediate) Results only. Little is reported regarding the general progress towards consolidated institutional capacity, effective and viable program development or constraints encountered.

The four Results for Phase II and their indicators are vaguely formulated and largely un-measurable. While the Activities are relatively specific, they have not been qualified, so it is difficult to measure what constitutes success. This has led project management to report primarily against quantitative targets (number of trainings, participants, centers, groups etc.).

A Results-oriented project design is paramount to ensure effective management and dynamic implementation. When Results cannot be measured, 'success' cannot be defined, and 'progress' cannot be determined. The VBCP displays symptoms of a static project that is satisfied with meeting the quantitative targets set in the 4-year old Project Document rather than monitoring their relevance in the rapidly changing market, and on accounting for the project funds spent, rather than documenting their impact.

The proposed Logical Framework for Phase III seeks to address this issue by proposing measurable indicators and targets for each Activity, Result and Objective. This will enable project management, implementers and supervisors at all levels to monitor progress, and address constraints if set targets are not met in a timely fashion.

In addition, it is recommended that disbursement of funds during Phase III is linked to documented performance at all levels of project implementation.

6.4 Decentralization for Increased Market Responsiveness

The VBCP is the only donor-funded microfinance project fully embedded in the VWU.

- A Project Steering Committee comprising the two Governments and project management is established with a VWU Coordinator as chairperson;
- The Central-level PPMU was established within the VWU department for Family and Welfare, despite the existence of a separate department already managing the *Tau Yu Mai* (TYM) Revolving Fund Project established in 1992;
- *Permanent* Project Management Units (PPMUs) are established at the central (1), provincial (17), district (87) and communal (207) levels of VWU staffed by full- and part-time staff that report to the Central PPMU.

The Project Steering Committee (PSC) of the VBCP has been unusually directly involved in the operations of the project. Despite the broad supervisory mandate, the infrequent (annual) meetings, and the limited technical microfinance expertise of the PSC, several operational issues

have awaited its approval. With the clear strategic managerial responsibility of the project co-directors, this is inappropriate.

The operational character of decisions referred to the PSC suggests limitations in the decision-making powers and dilution of responsibilities. Presumably to address this weakness, an experienced development economist, albeit with no prior microfinance experience, has been appointed to act as project Co-Director and *permanent* advisor, but the decision-making authority of the Central PMU still appears limited.

The Province PMUs are the real 'implementation management hubs' for the VBCP activities. They should therefore be the focal point for continued project support, and be given direct responsibility for implementation, accompanied by appropriate decision making powers and a performance-based monitoring mechanism, including Annual Implementation Plans, Budgets and performance targets.

The VWU organizational structure at District level has not been imperative to an effective project design, and in all aspects the role of this level in project implementation has been limited. There is no immediate justification for the project to continue support to this level of VWU organization in Phase III, and it is recommended discontinued, except in areas where reaching remote Communes necessitates the District structure, or for specific activities, e.g. the strategic linkages to business development service providers.

By contrast the Commune VWU PMUs is where the action is. Volunteers (group leaders, center leaders) and part-time VWU staff mobilize and train women, visit borrowers, appraise loans, collect savings, fill out the paperwork and report to the Province PMU. Often, they have also been instrumental in linking clients to banks in the area, and contacting business development service providers. They have been conducting these functions remarkably well during Phase II. By delegating the implementing responsibility to the Province PMUs, it is expected that the work at the Commune (village, hamlet, center, group) level will be better facilitated, through faster and more demand-responsive decision making and support.

The draft Project Implementation Plan recommends the decentralization of implementation responsibility to the Province PMUs during Phase III.

6.5 Enhanced Technical Assistance

The VBCP has had very limited interface with the dynamic national, regional and international microfinance industry, and thus limited exposure to international standards of performance in microfinance. Surprisingly little of the initially planned 160 person months of external short-term TA has been contracted during Phase II. Therefore the project has been sheltered from direct performance-based comparison with other providers, and consequently, the comparative technical quality of the VBCP is not well appreciated internally. From an external perspective, however, the quality and content of policies, trainings and operations manuals produced by the project do not meet the standards expected. Given 6 years of operation, the level of capacity built is modest, and there is little evidence of strategic vision and positioning of the project in the wider microfinance context in Viet Nam.

The Central PMU has ensured an excellent level of project fund management and good quality reporting against the existing project activities. But with the proposed Phase III – and the preparatory activities proposed in the Extension of Phase II - the goal post is raised. Whether due to insufficient technical capabilities, lack of independent space for decision-making of the PMU within the VWU or other reasons, the current level of managerial strength, commitment and strategic overview does not appear sufficient to ensure the success of Phase III.

For these reasons, the approach for capacity building needs to shift from embedded advice and generic classroom courses to flexible and needs-based, on-site technical assistance of a higher quality than hitherto experienced. Several resources for microfinance are available in the Asian region, which should be tapped into, including ARCM (Asia Resource Centre for Microfinance), EDA/MCRIL for ratings, and the CGAP-supported Microfinance Hub for Asia. MicroSave Asia is due to be established in India in 2005. Closer coordination with other providers of microfinance in Viet Nam could also facilitate access by VBCP to improved technical assistance.

The proposed design of Phase III is budgeted to ensure that technically superior training and external technical assistance will be made available to VWU, the Central PMU and the Province PMUs.

6.6 From Project to Sector Development Approach

So far, the VBCP has taken a classical, insular project approach in its service provision. While some coordination and linkages have been established at Province and Commune PMU level, the central PMU has not focused on coordination, coherence and cross-project learning with other ongoing initiatives within VWU. The lack of coordination with the TYM project is surprising, and has no doubt limited the learning otherwise possible. While the VBCP permanent advisor has recently attended some meetings of the MFWG, and the VWU (but not the VBCP) has attended briefings on the Draft Microfinance Decree, the VBCP as a project has not engaged much in microfinance sector development.

In parallel with the VBCP, a significant number (40 projects in 2000) of other savings and credit schemes sponsored primarily by international NGOs are executed in partnership with the VWU at Province, District and Commune levels all over Vietnam. VWU is thus collaborating – albeit in an uncoordinated manner - with almost all of the formal and semi-formal microfinance providers. But there is little contact, no agreed definitions of Good Practices and performance standards, and very little sector-wide information and performance monitoring available. This may change with the efforts of the newly established, informal Microfinance Working Group (See Annex 4), and the consultations on the Draft Microfinance Decree.

The introvert project approach is no longer appropriate. VBCP needs to reflect a more market oriented approach, which acknowledges the many other financial service providers in the environment. The obvious comparative advantages of VWU as a representative and influential national organization should be fully exploited during Phase III.

The need for increased coordination among the micro-credit and savings projects implemented by the VWU has been recognized in the Results agreed by the Joint Commission in December 2003. The Activities proposed under Result 3 for the VBCP Phase III (see section 7.3) aim to assist the VWU in using its position, strengthened capacity and experience in a new role as supporter and advocate of Good Practice microfinance at the national level in Viet Nam.

6.7 After Phase III: Microfinance Provision or Facilitation?

When designing the Vietnamese-Belgian Credit Project in 1997, the chief rationale was the desire of the political mass organization Vietnam Women's Union (VWU) to actively contribute to the Government's HEPR strategy. The Belgian Government supports poverty reduction and gender sensitive microfinance, and in the under-developed microfinance industry of the late 1990s, the VWU was an appropriate partner for the aim of increasing access to credit by the poor. At that time, credit was primarily available through ROSCAs and other informal providers. This has changed dramatically, and formal financial institutions now dominate the microfinance market, offering financial services more in tune with the needs of the poor, including many VBCP clients.

VWU occupies a central position in the political economy, has a huge, nation-wide network of 11 million members, and a clear focus on the advancement of rural poor women. The mobilization of poor women into savings and credit groups, offering access to basic training in group management, financial skills and non-financial Business Development Services (BDS) falls square within the mandate of VWU.

It is neither obvious nor documented, however, that VWU as a political mass organization with a broad agenda would be interested in performing the arduous task of transforming itself in part or fully into a provider of market-responsive, sustainable and donor-independent microfinance, as foreseen by Joint Commission when outlining the objectives of VBCP Phase III in December 2003. The reasons are sought summarized in Table 1 overleaf.

While VWU has an excellent track-record as a *facilitator* of increased access by poor women to financial and non-financial services, it is thus not the most obvious choice as a sustainable microfinance service *provider*.

Indeed, the VWU seems already to have recognized this, and has been pioneering excellent alternative strategies: Several of the donor- and INGO-sponsored microfinance projects implemented in cooperation with the VWU have developed links to formal financial institutions for their clients, providing clients with sustainable access to credit as well as legal and professionally provided savings services. Of particular note is the Vietnam-Canada Rural Finance Outreach Project completed in December 2003, at the end of which VWU signed an Institutionalization Plan to roll-out specifically developed and successfully tested microfinance savings and credit products provided by VBARD to rural poor women mobilized into groups by VWU across the country. Similarly, at the end of the UNICEF-funded savings and credit project, clients were linked to banks, and the loan fund reallocated for capacity building.

With the dispersed outreach, organizational structure, efficiency levels, and financial performance of the VBCP after 4-6 years of operations, and even taking into consideration what can be hoped achieved during Phase III, there is little scope for transforming this project into a sustainable MFI. As a consequence, the need for financial sustainability of the savings and credit activities of VBCP during Phase III is less related to regulatory requirements than to the management of risk, given the intermediation of savings, and to appropriate exit strategies at the end of Phase III.

With the Draft Decree not yet adopted by GoVN, however, there is still time to further ponder the option for VWU to use one of its other projects as the basis on which it may wish transform itself into an MFI or establish a subsidiary.

During the discussions of the draft project design for Phase III, the VWU confirmed that the organization will not embark on the arduous task of transforming itself into an MFI for the duration of the VBCP Phase III. The proposed activity 3.5 of Phase III (see Section 7.3) aims at generating the basis for a more informed final decision on the option of providing microfinance services in the longer term as one of several business options for the VWU.

Table 1: Comparative advantages of VWU as a specialized MFI

| Successful microfinance provision requires: | VWU strengths include: |
|---|---|
| <p>1) A single-minded focus and commitment by the governing body and management to commercially viable provision of financial services. International experience demonstrates that private sector entities are better suited to succeed in microfinance, and that government-sponsored provision tends to fail.</p> | <p>1) The mandate of VWU is primarily social and much broader than microfinance, and it is a non-profit, government/party organization.</p> |
| <p>2) A large, potential market of un-served poor people. The poverty rates in Viet Nam are decreasing fast, and the dynamism in the private sector coupled with the outreach of the formal financial providers result in a limited traditional microfinance market. Competing successfully with the banks, especially as one of them (VBSP) is state-subsidized is going to be very difficult.</p> | <p>2) While there is scope in the more remote areas inhabited primarily by ethnic minorities for successful microfinance, the VWU with its national network and office structure and almost exclusive Kinh membership is challenged to meet that demand, but Phase III will seek to promote outreach to the minority areas.</p> |
| <p>3) Competitive and market-responsive selection of areas of operation and target clientele. There must be enough clients demanding the services offered in the selected locations to justify the operation of a branch, growth must be organic to ensure economies of scale, and clients must be economically active and perform well.</p> | <p>3) The VWU has an inherent responsibility to distribute its services somewhat equally across its nation-wide network, and to focus on the needs of its members where they are, using its existing institutional structures (offices) at Provincial, District and Communal levels.</p> |
| <p>4) The recruitment and retention of highly qualified, technically specialized, and fully committed management and staff working exclusively to ensure the objective of sustainable provision of financial services to the poor.</p> | <p>4) VWU has a staffing structure of voluntary members and multi-skilled permanent staff that are rotated and assigned part-time to several projects.</p> |
| <p>5) Extreme efficiency of systems, procedures, staff utilization, management decisions etc. This is particularly true in countries like Viet Nam, where the financial spread is low due to the interest rate policies of GoVN/SOCBs.</p> | <p>5) Neither the centralized decision making structure, nor the civil service-like internal policies and HR management of the VWU enable the level of efficiency required, and the efficiency ratios of the VBCP are well below the regional average.</p> |
| <p>6) Strategic, technically well-founded and decisive financial management capabilities to optimize liquidity, leverage, investments and costing of services; to secure excellent portfolio performance; and to protect the monies that they are entrusted with. This requires the ability and willingness to analyze and compete in the financial markets, as well as to e.g. evict non-paying clients from their houses, if these are pledged as collateral.</p> | <p>6) The financial management capacity within the VWU even after 6 years of training in the VBCP remains insufficient for the requirements of an MFI, and the hard decisions sometimes necessary in microfinance would go counter to the entire VWU social mission of protecting poor women.</p> |
| <p>7) Profitability. Breaking-even with subsidies from donors cannot ensure the long-term survival of an MFI in the market place, and the Decree requires sustainability. To be profitable, an MFI must achieve substantial scale, minimize costs, charge cost-covering interest rates, and be competitive, i.e. continuously develop and innovate products. As interest rates are not completely liberalized, it will be very difficult for even the leanest, meanest MFI to attain profitability in this market at present.</p> | <p>7) The VWU may have developed an interest in microfinance provision due to its potential as an income stream. In the Vietnamese financial environment, however, the prospects of VWU generating any income from microfinance provision are very slim indeed. The VBCP is not covering its operational costs after 4-6 years of operations.</p> |

7. Phase III Draft Design of the Intervention Logic

The Project as proposed and recommended above is summarized in the Logical Framework Matrix in Section 1, and the activities elaborated in Annex 5, with a time-line given in Annex 6.

7.1 Goals and Purpose

As agreed by the Joint Commission in December 2003, the common aim of the Belgian support to VWU and VWU's engagement in microfinance is "sustainable poverty reduction and entrepreneurship development with Vietnamese rural women through the provision of microfinance and capacity building". The project Purpose agreed is "to set up a performing savings and credit scheme geared towards rural women with a sound, legal, institutional and financial basis that is no longer dependent on donor funding".

During the Identification Mission, the VWU confirmed, however, that the information necessary to take an informed decision on the option of transforming the organization in full or in part into a regulated MFI under the Decree is not yet available. Therefore, the Purpose of VBCP Phase III has been adjusted to expand the facilitating role of the VWU for Good Practice Microfinance, while providing the information and assessments needed to take a final decision on this matter. As such, the VWU will not be transforming into an MFI for the duration of the VBCP Phase III.

Based on the market analysis and in order to ensure relevance and orientation towards measurable results in project implementation, the overall objectives are proposed deconstructed and formulated in concurrence with the Millennium Development Goals as follows:

The overall Goal (Development Objective) to which the VBCP Phase III will contribute is:
The incidence of poverty is reduced by 40% among households in Viet Nam by 2010, as compared to 2000.

The verifiable indicator for the Project Goal is:
The Incidence of Poverty is reduced by 33% by June 2009, as compared to 2000.

The Purpose (Immediate Objective), which the Project is designed to achieve, is:

By end of June 2009, XX %²⁰ of economically active poor households in Viet Nam has access to high-quality and diversified financial and business development services, provided by coordinated and market-responsive providers following Good Practices for sustainable service delivery.

The verifiable indicators for the Project Purpose are:

- Outreach to poor clients by semi-formal microfinance programs reporting reliable data has increased by min. 20% p.a.
- Microfinance portfolio of regulated financial institutions has increased by min. 10% p.a.
- BDS providers meet minimum 80% of the documented demand of solidarity groups of poor clients.

7.2 Results

The Joint Commission agreed on the following four Results ('objectives') for the VBCP Phase III:

1. Transition from basic poverty reduction to the creation of economic power for rural women, by helping them to set up their own micro-enterprises;

²⁰ The VWU has requested time to set the actual targets for the indicators at this level, and the specific targets should thus be finalized during the Formulation Mission for Phase III.

2. Strengthening and consolidation of the institutional capacity of the VWU at all levels in the field of micro-savings and credit, management and accounting, monitoring and policy design;
3. Contribution to the integration of the different micro-credit management and accounting systems that currently exist within the VWU, thus facilitating the establishment of one consolidated and highly professional entity specialized in micro-savings and credit;
4. Contribution to the elaboration and implementation of a legal framework and a prudential regulation for micro-savings and credit in Viet Nam.

These objectives are included in the recommended Results framework for Phase III. In order to support the achievement of the Purpose, however, the objectives have been deconstructed, quantified and qualified. Keeping in mind that project management will be held responsible for accomplishments at the Results level, and hence to ensure that progress is measurable, four interlinked Results are proposed for the VBCP in Phase III as follows:

Result 1: By the end of June 2009, XX % of poor women in the targeted Provinces have access to diversified financial services provided by regulated financial institutions.

Verifiable indicator for Result 1:

- No. women accessing services from regulated financial institutions in the targeted Provinces is increased by 25% p.a.

Result 2: By the end of June 2009, XX % of poor women in the targeted Provinces have access to demand-driven training and business development services provided by public and private suppliers.

Verifiable indicator for Result 2:

- No. women accessing training and BDS services in the targeted Provinces is increased by 30% p.a.

Result 3: By the end of June 2009, a Good Practice-based microfinance industry reports reliable performance data and advocates for a conducive regulatory environment, and VWU has determined its future role in microfinance.

Verifiable indicators for Result 3:

- Min. 10 MF providers and 4 donor agencies have adopted and use a standardized performance reporting format by end of project
- When effected, the Microfinance Decree and Regulations are acceptable to min. 50% of MFWG members
- A 3-5 year Strategic Business Plan for the VWU is adopted by VWU leadership by end of project

Result 4: An efficient management structure for VBCP is continued, ensuring results-oriented and performance-based progress, and accurate expenditure controls.

Verifiable indicators for Result 4:

- Targets set in Annual Work plans are met;
- Performance Progress reports and financial accountabilities are accurate and on time.
- Appropriate exit strategies are developed, adopted and executed before the end of Phase III.

Project management is seldom included in the actual Logical Framework Matrix of development projects, but it is helpful tool for project management units against which to measure progress, and to justify the time and effort spent on ensuring efficient internal management processes.

At the request of the DGDC at the final debriefing for the Identification Mission, and to better reflect the new key roles of the VBCP Phase III, The Identification Team would like to propose the of the VBCP changed to "ACCESS": Access to Coordinated Credit and Enterprise Support Services. The Formulation Mission may have a better suggestion for a new name for the VBCP.

7.3 Activities

Activities in the Logical Framework are the (main) measurable tasks to be carried out in order to produce and sustain each of the Results. The following section summarized the main activities recommended in preparation for Phase III during the Extension of Phase II, i.e. during 2005, and the activities to be undertaken in Phase III. As results-orientation through measurable indicators is new to the VBCP, Annex 5 presents in further detail the rationale and sequence of the main activities as well as the indicators of success. An indicative time line of activities to be accomplished during the Extension of Phase II and during each year of the 3.5 year long Phase III is presented in Annex 6.

7.3.1 Activities for Result 1: Access to Financial Services

7.3.1.1 Segment the Current Clientele

During the 1-year extension of Phase II (January-December 2005), it is recommended that the VBCP undertakes a segmentation of its current clientele, which will determine the level and type of services they can expect to access during Phase III. New clients mobilized should be exclusively or at least primarily from among the poorest and least served women. VBCP should provide the basic mobilization and savings and credit training delivered also during Phase II.

7.3.1.2 Update the Savings Products

Within the Extension of Phase II, i.e. before 31 December 2005, the systems and procedures for the savings products of VBCP should be reviewed and revised in consultation with the Province PMUs.

7.3.1.3 Link Resourceful Clients to Banks

Starting from the last month of the current loan cycle, and latest by the end of Phase III, Year 1 (2006), the VBCP should facilitate the successful access by the more resourceful clients to loans from formal financial service providers (VBARD, VBSP, PCFs etc.) under existing and/or renegotiated Framework Agreements. This will free up funds for on-lending to new poorer clients mobilized. Clients linked to banks should be free to withdraw their compulsory and voluntary deposits from the VBCP and place these with the banks. To avoid liquidity crises, an amount equivalent to the total deposits of all clients no longer eligible for VBCP loans must be kept available in liquid funds with the Commune/Province PMUs.

7.3.1.4 Provide 'Incubation Loans' to Poor Clients

The existing VBCP loan funds should be used to lend exclusively to existing and new poor clients mobilized into existing or new solidarity groups, starting January 2006. The clients should be offered the current product range of general and seasonal loans for a maximum total loan term of 36 months. Based on demand, Province PMUs should be free to adjust the loan terms within the maximum duration of 36 months. All clients should be issued with a savings and loan passbook. In the final 6 months of the VBCP Phase III, all efforts should be made to ensure access by all clients to specialized financial service providers.

7.3.1.5 Compile and Report VBCP Performance Data

The use of the MicroBanker loan tracking software should be continued, but large investments in its upgrading may not be warranted. In addition, Province PMUs should accurately record their portfolio performance; and assets, actual income and expenses in an income (profit/loss)

statement and a balance sheet encompassing all credit-related activities, so that the levels of cost coverage of the microfinance activity can be assessed.

It is recommended that the internationally recognized Performance Monitoring Tool (PMT - see introduction, Annex 7) be introduced and adapted to the Vietnamese setting for the purpose of reporting portfolio and financial performance by all Province PMUs.

To accomplish this, a series of Province-level trainings in financial and portfolio performance reporting should be initiated as soon as possible, and completed prior to the start of Phase III in January 2006 (See sample training program, Annex 8).

7.3.1.6 Compile and Report Province Microfinance Data

Performance reporting for the VBCP should be accomplished monthly by the Province PMUs in the PMT format, and submitted quarterly to the Central PMU for consolidation and monitoring.

In addition, the 17 Province PMUs should contact all other microfinance (savings and credit) providers/projects in their respective Provinces to collect and compile the performance of all projects in the standardized PMT format. The increased Province level coordination would also contribute to lateral (cross-project) learning so that less well functioning schemes can improve performance, and so that all providers may work towards compliance with general Good microfinance Practices:

The Central PMU should forward the consolidated data to the Microfinance Performance Monitoring Unit proposed established within VWU during Phase III (see Section 7.3.3.2). In this way, the VWU can gain an overview of the actual performance of all microfinance activities currently undertaken, and can provide this data to other stakeholders, including non-VBCP Province VWUs that support microfinance.

7.3.1.7 Develop Exit Strategy for Use of Loan Fund

During the last 6 months of the Project (2009), the 17 Province PMUs – preferably in regional workshops – should be guided by technical assistance to decide on the options for divesting their remaining portfolio of credit clients to microfinance provider(s), and utilize the Credit Fund for purposes that provide the greatest leverage of the project investment.

The Province PMUs should submit their proposals to the central PMU, which should seek Project Steering Committee approval of the proposed investment plans (as revised in consultation with the Central PMU).

7.3.2 Activities for Result 2: Access to Non-Financial Services

7.3.2.1 Conduct Needs Assessments to Determine Demand

It is recommended that a Training and Business Development Services (BDS) Needs Assessment is carried out in preparation for Phase III, i.e. before the end of 2005, and that this assessment is updated annually at Province level.

Province PMUs should send a copy of their Assessments to the Central PMU for consolidation and dissemination to all Provinces (including non-VBCP Provinces), the MFWG and donor agencies/projects involved in BDS provision, etc.

7.3.2.2 Compile and Distribute BDS Directory

In consultation with current providers, NGOs, LPCs etc., the Province PMUs should identify and distribute a Registration Format to as many Training and BDS service providers as possible in the each Province. As coordinators of much of the existing extension services, the District VWU offices are important sources of information in this process.

Information on available services thus received should be consolidated into a "Training and BDS Service Provider Directory" for each Province. Registered BDS service providers should receive a copy of the Training and BDS Needs Assessment. Province PMUs could add information on bank trainers, social service providers, and the training offered by VBCP/PMU/VWU staff.

The Directory should be updated regularly (at least annually), and disseminated to all center leaders, and via the Central PMU to all VBCP and non-VBCP Provinces. Province PMUs could also consider selling the Assessment and Directories to other interested parties (NGOs, donor agencies/projects, LPCs etc.).

7.3.2.3 Develop Strategic Linkages with BDS providers

To promote better market linkages, the Province PMU should facilitate opportunities for demand (groups) and supply (service providers) to meet and align expectations. This can be arranged e.g. as informal visits of providers to center meetings; BDS Trade Fairs organized by providers to which groups are invited; or 'test trainings'.

To position the Commune and Province PMU/VWU as efficient coordinators of BDS, they should develop strategic alliances with service providers to ensure better access by VBCP group members to demanded services, and delivery of quality services. Framework Agreements could help secure the relationship and harmonize the cost.

7.3.2.4 Monitor, Evaluate and Report Performance

All training and BDS services contracted by the VBCP during Phase III should be evaluated by participants in terms of relevance and value for money. The results of the evaluations should be compiled at Province PMU level, and preferably included in the annually updated BDS Directories.

The Commune and Province PMUs should compare the available BDS and training supply (the Directory) and the BDS and Training Needs Assessment. Where gaps are identified, the Directories received via the Central PMU from adjacent Provinces should be consulted, and PMUs should be encouraged to refer high-quality service providers to each other.

A specific section in the quarterly narrative report from the Province PMUs to Central PMU should be developed for reporting on this activity, and preferably disseminated to all Provinces. Identified demand-supply gaps should be reported, so that the Central PMU can help address any general mismatches through e.g. training of trainers at national level or contracting of international technical assistance.

7.3.2.5 Develop Cost-Sharing Models for BDS services

For Phase III, Province-specific BDS Provision Policies should be developed based on the principle of cost-sharing, and discontinue supply-driven and fully subsidized BDS.

A general demand-driven BDS Provision Guideline should be developed by the Central PMU, and sharing of experiences across Provinces should be facilitated, as successful cost-sharing models emerge.

Based on the actual costs of demanded training and BDS, and the cost-sharing that groups/centers and communes can afford, the Province PMUs should review their options for cost-coverage through cost-cutting, fund raising or income generation.

Province PMUs must be allowed to test and decide which models work best for them, and may need technical assistance in the process. The models developed in this activity could serve as a basis for developing more general cost-covering systems for the VWU operations at Commune and Province level.

7.3.2.6 Establish BDS and TA Matching Grant Fund

For the duration of VBCP Phase III, it is not realistic to assume that many VBCP groups and PMUs will be able to raise the funds necessary to procure training and BDS services at full market rates.

To ensure access by the VBCP groups to the demanded services, it is therefore recommended that a BDS Matching Grant Fund is established and managed at the Central PMU, to which Province PMUs can apply for funds to close the funding gap.

It is recommended that the Fund includes a window for technical assistance and training for the Province (and Commune) PMUs themselves. This would enable Province PMUs to apply for funds (or TA in kind) to address specific operational constraints encountered. The Central PMU would also be able better to allocate internal resources to the demands they can meet immediately, while accessing external technical assistance for demands outside of their areas of expertise.

The eligibility criteria, application, appraisal, disbursement, accounting and performance monitoring policies and procedures of the Fund should be developed in detail during the Extension of Phase II, so that it is operational as at 01 January 2006.

7.3.3 Activities for Result 3: VWU Microfinance Sector-Support

7.3.3.1 Consolidate VBCP Performance Reporting

The Central PMU should receive, analyze and consolidate the 17 quarterly financial and portfolio performance reports *and* its own financial data into a quarterly overall performance report for the VBCP in the PMT format. The consolidated data would enable the mapping of VBCP microfinance activities across the 17 Provinces.

The consolidation of the loan tracking information in the MicroBanker should continue at the current level so that the Province PMUs have access to technical support and maintenance services.

7.3.3.2 Consolidate Microfinance Performance Reporting in VWU

To address the lack of a joint financial and performance reporting system within VWU, it is recommended that the PMT format be adopted for use by all the microfinance activities currently managed by the VWU at central level, in particular the TYM. The PMT is designed to accommodate any method of microfinance provision.

This would involve introduction and possible adjustment of the generic PMT format; adjustments of currently used charts of accounts; installation of the PMT and training of staff at PMU, TYM and any other management units for savings and credit activities at the central VWU.

To accomplish this, it is recommended that a separate unit – the *Microfinance Performance Monitoring Unit (MPMU)* - is established at the Central VWU. The MPMU will be charged exclusively with the responsibility for collecting, compiling, consolidating and disseminating microfinance performance data on behalf of all projects supported by the VWU. VBCP and the TYM could contribute staff and equipment to this separate Unit. It is recommended that an interim, external technical advisor be recruited and placed in the VWU MPMU.

7.3.3.3 Support Coherent NGO-Microfinance Performance Reporting

Once established, the VWU Microfinance Performance Monitoring Unit (MPMU) should promote the usage of a standardized performance reporting format (the PMT) in all microfinance projects currently implemented by (I)NGOs in collaboration with the VWU, by:

- presenting the results on the internal VWU performance reporting and mapping to the Microfinance Working Group (MFWG); and

- engaging the MFWG members in a consultative process to adapt and adopt the PMT as a reporting tool for all microfinance projects in Viet Nam.

The MFWG is currently building a database of performance information (see Annex 4). It is therefore recommended that the VBCP Central PMU engages immediately and actively in the MFWG to introduce the PMT, and procure international technical assistance to provide training and adaptation of the generic PMT.

7.3.3.4 Support Performance-based Dialogue with SVB and Donors

The VWU through its MPMU should contribute to a more consultative dialogue with the State Bank of Vietnam, the donor community and the Government of Vietnam, in particular the Ministry of Finance and the Ministry of Planning and Investment that will develop the regulations for the Microfinance Decree currently being drafted.

The VWU (MPMU) could play an important intermediating role in ensuring that practitioners are consulted, international experience is taken into account, and technical assistance is made available as needed in the process of finalizing the Decree, developing its regulations, and preparing MFIs for transformation.

Equally, the VWU MPMU should facilitate a more coordinated approach to the donor community by the microfinance practitioners in Vietnam, and promote the PMT as a joint reporting and monitoring tool for microfinance used by all donors.

7.3.3.5 Conduct Feasibility Study on Future VWU Role in Microfinance

It is recommended that an in-depth Feasibility Study be conducted at the end of Year 2 of Phase III to determine whether the VWU should establish an MFI (or transform an institutional unit into an MFI) at the end of Phase III. If the conclusion is made not to establish an MFI, the Feasibility Study should provide recommendations on divestiture of any remaining microfinance portfolio to other providers, and on the usage of the remaining credit fund for the ultimate approval by the Project Steering Committee. These recommendations should *inform* but not exclusively direct the subsequent process of Province-level divestiture and re-investment of the decentralized Credit Funds (see Section 7.3.1.7). The MPMU should take an active role in preparing and facilitating the feasibility study.

To secure the longer-term survival of the VWU as a vibrant mass organization, it is necessary that the VWU develops sustainable income-streams generated increasingly in the domestic, private market to replace project-based donor funds. It is therefore recommended that the VBCP supports an institutional Strategic Business Planning Process to be initiated, managed and driven by the VWU leadership over the course of Phase III. Support under this activity could include action research, studies and TA.

7.3.4 Activities for Result 4: Efficient Project Management

7.3.4.1 Produce Work Plans and Budgets for Performance-based Disbursements

The overall budget for the VBCP Phase III should be finalized during the Formulation Mission, and approved by the Project Steering Committee (PSC).

Each Province PMU should develop annual Project Implementation Plans (PIPs) with a budget and targets for each indicator to be approved by the Central PMU. Release of operational budgets from the Central PMU to Province PMUs should be based on documented performance as per the targets set. Provinces may thus 'self-select' their involvement in the Project during Phase III: poor performance should trigger initial technical assistance, but a mechanism must also be put in place

to halt support if performance does not improve rapidly. It is recommended that the Province PMUs adopt the same performance-based system when allocating funds to Commune PMUs.

Based on the Province PIPs, the Central PMU should prepare annual consolidated Work Plans with budgets and targets for the approval of the PSC.

The PSC should release the overall project budget in annual tranches based on documentation that the targets set for each preceding year have been sufficiently met.

7.3.4.2 Update Policies, Procedures and Manuals

With the delegation of implementation responsibility to the Province PMUs, the Operational Manuals and Procedures for the project should be reviewed, revised and updated within the Extension of Phase II, i.e. before 31 December 2005. It is important that the decision-making authority and responsibility of the Province PMUs is clearly stated.

It is recommended that short-term, qualified technical assistance be contracted to assist in this consultative 'review and renovation' process. Equally, external auditors should be contracted to verify the value of the Revolving Funds in all Communes/Provinces.

7.3.4.3 Implement and Monitor Project Progress

VBCP activities as approved in the annual Work plans and Budgets and as measured by indicators and annual targets should be implemented according to plan, and carefully monitored to ensure achievement of the programmatic results.

Annual VBCP Review Workshops for all PMUs are recommended to help finalize Province PIPs, review progress, and recommend on revisions of the overall project design for Amendments of the Technical and Financial File. These Review Workshops should replace the Province PMU participation in the PSC.

The complete Logical Framework Matrix proposed is presented in Section 1.

7.5 Assumptions and Risk Analysis

The design of the Phase III as recommended above reduces the risk to the project as compared to a continuation of the current situation, in particular with regard to the external risk posed by the draft Microfinance Decree. The main reason is that the VBCP will gradually move from direct microfinance provision to facilitation of access through the incubation process described. With the design proposed, the BVCP is no longer directed towards becoming an MFI and thus avoids the many uncertainties that the new legal framework poses. Further, this also reduces internal risks related to the implementation of complex credit and savings procedures, and external risks stemming from competitive pressures in the microfinance sector.

The main external risk to the project is considered to be a scenario where GoVN restructures the VBSP into a purely commercial bank, and transfers policy lending to mass organizations like VWU, which will then be saddled with the responsibilities as a political vehicle of providing subsidized financial and technical services to particular target groups. This would seriously undermine the efforts of the project to streamline the role of the VWU as a facilitator and coordinator of sustainable services to poor women. In effect, such a move would turn VWU-supported microfinance back into subsidized, multipurpose development programs.

The Team assesses the risk for this development as low, and no political signals in that direction have been detected. The trend seems to be towards more market-orientation and less political interference. However, given the political economy of Vietnam the possibility cannot be completely discounted.

Assumptions: Overall Goal

The goal of reduction in poverty hinges on continued high economic growth in Viet Nam that is equitable and evenly spread throughout the country. This again requires a stable political and economic environment, including absence of global economic shocks.

In the past decade, Viet Nam has proven that it can attain the necessary levels of growth even with global instability, and the latest assessment of the MDG for Vietnam²¹ rates it as “probable” that Vietnam will reach the target of halving extreme poverty in the country by 2015. The state of the supportive environment is likewise rated as “strong”.

Assumptions: Purpose

The main external assumptions for achieving poor household access to sustainable financial services and BDS are firstly that a conducive legal framework for MFIs is put in place, secondly that the GoVN gradually reduces the distortions in the sector (interest rate and VBSP subsidies), and thirdly that a free market for BDS is allowed to develop.

The Team is cautiously optimistic on all three assumptions, but the second – reduction in distortions – might be the most difficult. However, there seems to be a clear understanding among major stakeholders that the financial markets will see increasing liberalization, and that VBSP might align with the other banks over time. None of these assumptions are considered fatal to the project, and VBCP can live well with limited progress in all three.

The last assumption is a negation of the risk described above, namely that VWU is not made a new political vehicle for providing subsidized credit. That would seriously hamper development of sustainable microfinance in the country, in addition to harming VBCP as such.

Assumptions: Results

To achieve Result 1, the new MF Decree needs to be conducive to the establishment and growth of MFIs, and banks need to expand their activities under the current Framework Agreement with the MOs in the affected provinces.

To achieve Result 2, BDS markets need to expand and develop in the targeted provinces, with support of GoVN and other donors.

To achieve Result 3, MF stakeholders need to agree on coordinating activities, and accepting common standards for reporting performance. For the VWU microfinance role, decision making must be decentralized and delegated to competent management units in VWU.

To achieve Result 4, funds and other input agreed on must be disbursed timely by the donor, VWU leadership must actively support the new roles of the Project and the Project Steering Committee must monitor the project's performance.

The risk may be most pronounced with regard to the conduciveness of the Decree and potential establishment of new MFIs in the targeted provinces. However, as the formal financial sector is fast expanding, this risk is assessed as controllable.

²¹ IDT/MDG Progress Vietnam, UN Country Team.

Assumptions: Activities

The assumptions are listed in the LFA matrix (See Section 1), and only a limited number of these external assumptions are found to be "critical" for the activities and the project. Most of the uncertainty is connected to the quality and the timeliness of the TA input that the Identification Team assesses as of core importance. It is crucial for the Project only to accept high standard and well qualified TA, that has extensive specialized experience, is professionally competent and that can communicate effectively in the Vietnamese environment.

A second assumption pertains to the level of acceptance and commitment among major stakeholders inside and outside of VWU to developing a more coordinated approach to the microfinance sector. The signs so far seem positive, as most involved institutions currently complain about a fragmented approach. However, it is vital that VWU engages in the industry coordination activities as a professionally objective facilitator of better coordination of common ideas, issues and concerns, so that any perceptions of VWU as a controlling superstructure will be laid to rest.

7.6 Management of Implementation

7.6.1 Management at Province Level

For Phase III of the VBCP, it is recommended that the structure of *Commune PMUs* be maintained, while the *District PMUs* be phased out during the extension of the VBCP Phase II, except where the remoteness of project communes or the strategic alliances with BDS providers may require their continued involvement. In general, however, the provincial management structure during Phase III should include Commune PMUs and Province PMUs only.

The 17 existing *Province PMUs* should become the key implementing entities for the project activities. They have the experience, and seem generally well positioned to manage the results-based project execution, the linkages and the coordination functions with Communes and VBCP groups (vertically) as well as with other VWU projects, NGO-supported savings- and credit projects, and financial and non-financial service providers (horizontally) within their geographical areas. Guided by Annual Work Plans and budgets with clear performance targets and measurable indicators, and a coherent performance reporting tool, Province PMUs should be able to assume full, decentralized implementation responsibility delegated from the Central PMU.

It is recommended that the Province PMUs organize or formalize regular (e.g. quarterly) 'Project Implementation Review Meetings' with Commune PMU managers to discuss progress based on each Quarterly Progress Report submitted. These meetings should be minuted, and a copy of the Minutes sent to the Central PMU. To encourage further provincial coordination, representatives from District VWUs, LPCs, and other microfinance projects in the Province (NGOs, banks etc.) should be invited to these meetings. Equally, the Central PMU, province PMU leaders from other Provinces, the VWU MPMU and representatives of the Project Steering Committee could be invited, pending the agenda. In cases of perceived constraints related to project implementation involving the Central PMU or MPMU, the Province PMUs should have the option of corresponding directly with the Chairperson of the Project Steering Committee.

In order to encourage horizontal linkages and learning among the Province PMUs, one annual VBCP Workshop should be held facilitated by a project-external facilitator, to:

- Review progress across Provinces against targets set for the year;
- Present, discuss and recommend on solutions to constraints faced;
- Review the tasks and set the targets and budget for the coming year in Work Plans;
- Recommend on changes in activities, indicators and targets in the Project;
- Share experiences on linkages, cost-sharing models and successful coordination etc.

The first VBCP workshop should be held at end of the Extension of Phase II, i.e. by end 2005. This Workshop should result in all 17 Provinces having finalized their Work Plans with targets and budgets for Phase III, Year 1.

To emphasize the decentralization and results-orientation recommended for Phase III, the Workshop structure should replace the Province PMU representation in the Project Steering Committee.

7.6.2 Management at Central Level

The Central PMU is responsible for the day-to-day management of the VBCP as approved by the PSC, for the preparation and implementation of annual Work Plans and PIPs, and for the monitoring of progress.

As a consequence of the decentralization, however, the *Central VBCP PMU* should take on a more responsive back-stopping function, facilitating implementation, coordination and linkages among the 17 VBCP Province PMUs. The Central PMU should assist the PMUs in carrying out their functions, though:

- Timely approval of Province PMU Annual Implementation Plans and Budgets;
- Timely provision of project inputs, including information, funds, internal training and support to the MicroBanker and the PMT;
- Effective management of the BDS and TA Fund;
- Timely provision or contracting of demanded training, trouble-shooting and technical assistance.

The performance of Province PMUs should be monitored by careful analysis of the quarterly reports received, and any constraints indicated by delayed reporting or sub-target performance should be followed up, and discussed e.g. in the Quarterly Project Implementation Review meetings. If any Province PMU displays continued sub-target performance, the core funding to Project activities should be temporarily suspended, and investigative technical assistance or audits should be dispatched.

At the central level, the PMU should facilitate the establishment of the MPMU and the Strategic Business Planning Process for the VWU proposed for Phase III, including the management of contracts for the Microfinance Feasibility Study and action researches.

The Central PMU should manage funds as hitherto, and record their own income and expenditure in the MB and the PMT financial statements. To ensure overall coherence in the project, the Central PMU should report consolidated progress in quarterly Narrative and Financial Progress Reports to the Project Steering Committee, and retain its role as secretariat for the Project Steering Committee.

To assist in the internal coordination among microfinance projects managed by the VWU, it is recommended that a separate *VWU Microfinance Performance Monitoring Unit* (MPMU) be established at the central level.

Once established, the MPMU will be increasingly responsible for the national level coordination and linkages foreseen in VBCP Phase III, both regarding the horizontal linkages internally in the VWU (especially TYM and non-VBCP Provinces wishing to replicate or learn from the project), as well as externally to the stakeholders in the environment, including INGOs active in the Microfinance Working Group, the Government and State Bank, donors, BDS/training providers, and international microfinance resources like EDA, CGAP, technical assistants etc. The basis for successfully undertaking of this 'umbrella' function is accurate and reliable processing of information on outreach and performance.

Tentatively, the key functions of the MPMU would include:

- Establish database and communications systems to process data;
- Train and support all VWU microfinance management units in PMT reporting;
- Train and support e.g. TYM and VBCP staff at Province level in PMT reporting;
- Compile and consolidate quarterly PMT reports from VWU management units (including VBCP Central PMU and TYM), as well as from other NGO-projects supported by the VWU
- Present and discuss consolidated data and VWU outreach mapping with MFWG members;
- Train and support MFWG members in installing and reporting in the PMT format;
- Assist MFWG in dialoguing effectively with SBV, GoVN and donors;
- Disseminate consolidated data to microfinance stakeholders (MFWG, donors, SBV)

As this Unit will be funded from the VBCP, it will report to the VBCP Project Steering Committee through the Project Co-Directors, but it will implement its activities independently of the VBCP PMU, based on annual work plans and budgets and assisted by an externally recruited, technically competent consultant.

7.6.3 The Project Steering Committee

The composition of the *Project Steering Committee* during Phase III is recommended to include:

- VWU leadership
- BTC
- DGDC (Embassy of the Kingdom of Belgium, Ha Noi)
- Ministry of Planning and Investment
- State Bank of Viet Nam
- Ministries of Finance, Foreign Affairs and Government Office as appropriate
- Central PMU Co-Directors
- Manager of MPMU

Other staff of the VBCP should attend ex-officio as appropriate. Any member of the PSC may invite to discuss a specific issue on the agenda any one representative of any relevant institution not represented in the PSC.

The role of the PSC in a decentralized Phase III should include the following:

- Review and adopt the Program strategy (LFA) and Annual Work Plans;
- Adopt recommended core changes to the Project Design over time;
- Approve Annual Project Progress Reports with justification of expenditure as the basis for release of annual budget disbursements;
- Approve Contracts and/or Grant agreements if and when the total value of the VBCP engagement with a single recipient exceeds 50,000 Euros as presented by the Central PMU;
- Facilitate project implementation by strengthening linkages to GoVN, other donors etc.;
- Arrange for annual performance evaluations of the Program Management;
- Approve TOR and reports of reviews and evaluation missions;
- Approve TOR for and review audit reports.

While it may not be pertinent for the PSC to meet on a quarterly basis, it should convene at least every 6 months, or whenever at least two of its members request for a meeting. The secretariat for the PSC is the Central PMU, which will draft and circulate agendas and minutes of the meetings.

7.7 Results-based Monitoring and Evaluation

Due to the preparatory activities recommended for the Extension of Phase II (Apr-Dec 2005), it is strongly recommended that the activities, indicators and targets for this period be included in an Amendment to the Technical and Financial File for Phase II before the end of 2004.

As part of the Formulation Mission foreseen for Phase III (See draft TOR in Annex 10), the proposed indicators framework (see Annex 5 and 6) should be reviewed and overall *targets* should be set for each indicator. The final Logical Framework will form part of the Technical and Financial File for Phase III.

The LFA should then be 'deconstructed' into Annual Work Plans and Budgets for the Central PMU and Annual Project Implementation Plans/Budgets for each of the 17 Province PMUs, as finalized during VBCP Review Workshops.

The annual targets set in the Work Plans should form the basis of the monthly monitoring of progress by the PMUs and the Quarterly Narrative and Financial Progress Reporting at all levels of the projects, i.e.:

- Commune PMUs providing a simple narrative report and data for monthly performance recording in the MicroBanker and in the PMT;
- Province PMUs recording VBCP data in MicroBanker and the PMT on a monthly basis for monitoring purposes;
- Province PMUs reporting VBCP data quarterly in the PMT financial and narrative format to the Central PMU, and gradually including data from other NGO-microfinance projects in their areas;
- Central PMU reporting VBCP consolidated data in the PMT financial and narrative format to the Project Steering Committee on a quarterly basis (by mail), and during Phase III also providing consolidated data to the VWU MPMU proposed;
- All PMUs should meet annually to review progress, recommend of adjustments in the Project Design, and finalize the Work plans for subsequent years;
- The 4th Quarterly report from the Central PMU to the Project Steering Committee should include an overview of annual progress against targets, and proposals from the Review Workshops to revise and update the overall project Logical Framework as Amendments to the Technical and Financial File;
- This Quarterly Report should also include a request for disbursement of funding for the subsequent year for approval by the PSC, pending satisfactory progress.

Latest by the 3rd Quarter of Year 2 of Phase III, an external Mid-term Review should assess the project progress against the targets set, and recommend on any adjustments of the project structure, systems and implementation necessary to facilitate the attainment of the targets as set for the Project.

At the end of Phase III, a final, external Project Evaluation should assess the overall achievements and impact of the Project, focusing on the degree to which the Purpose has been achieved, and the contribution made to the overall Goal of poverty reduction. In the Provinces, the Evaluation should assess the extent to which the clients mobilized have been linked to sustainable financial service providers and are accessing BDS services as per their demand. At the Central level, the Evaluation should assess the level of coordination and maturity attained by the semi-formal microfinance industry as assisted by the Project, and the sustainability of the business plan for the Vietnamese Women's Unions future operations.

7.8 Input - Indicative Cost Framework

The all-important input for a successful Phase III is the timely recruitment of experienced and capable technical assistance. The production and dissemination of data, information, and documentation is an important part of the coordination function that the VBCP is proposed to take in Phase III. Equally important for the successful achievement of a coherent reporting framework for microfinance within VWU is the establishment of a Microfinance Performance Monitoring Unit separately from the central PMU, but reporting through the Co-directors to the Project Steering Committee.

The Identification Mission has prepared an indicative Budget Framework for the activities proposed (see Annex 9). The total cost is Euro 2.7 million. In addition, Euro 233,670 is proposed allocated from the existing budget for preparatory activities during the Extension of Phase II in 2005.

As part of the Formulation Mission foreseen for Phase III (see Annex 10), the proposed Project Design should be priced and, and the costing reviewed in detail. It is highly recommended that the Formulation Mission be contracted as soon as possible to allow for the commencement of preparatory activities foreseen during 2005.