ILO VIETNAM

Working Paper Series No.3

Entering a New Market: Commercial Banks and Small/Micro Enterprise Lending in Vietnam

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ILO Office in Viet Nam

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Entering a New Market: Commercial Banks and Small/Micro Enterprise Lending in Vietnam

By

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and
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December 2003

A study conducted for the International Labour Organization/Start & Improve Your Business (ILO/SIYB), in collaboration with the Social Finance Program (SFP), and the InFocus Program on Boosting Employment Creation through Small Enterprise Development (IFP/SEED)

ILO
Entering a New Market: Commercial Banks and Small/Micro Enterprise Lending in Vietnam
ILO Office in Vietnam, 2004

ISSN: 1727-8317

Printed in Vietnam

In preparing this report, valuable support was provided by
the Bank Training Center (BTC)

Bank Training Center

ACKNOWLEDGEMENT

The authors are grateful to all the commercial banks, donor institutions, and other organizations who have promptly responded to our surveys and graciously hosted our visit to their institution. Without their active participation and input, this study would not have been possible.

The authors would also like to thank Guillemette Jaffrin, ILO's Associate Expert in Ha Noi, and Jens Dyring Christensen, SIYB Chief Technical Adviser, for their continuing support and their constructive feedback to the initial draft of this report. The ILO Ha Noi administrative staff also deserves special thanks for their assistance with the mailing and collection of the survey questionnaires.

The authors are solely responsible for any inaccuracies in the study.

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LIST OF ABBREVIATIONS AND ACRONYMS

ACB	Asia Commercial Bank
ADB	Asian Development Bank
BDS	Business Development Services
BIDV	Bank for Investment and Development of Vietnam
BRI	Bank Rakyat Indonesia
BSP	Bank for Social Policies
BTA	Bilateral Trade Agreement
CCF	Central Credit Fund
CIC	Credit Information Center
EAB	Eastern Asia Commercial Bank
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GROA	Gross Return on Assets
GROE	Gross Return on Equity
GSO	General Statistics Office
Habubank/HBB	Ha Noi Building Commercial Joint Stock Bank
HE	Household Enterprise
IncomBank/ICBV	Industrial and Commercial Bank of Vietnam
IFC	International Finance Corporation
IFP/SEED	InFocus Program on Boosting Employment Creation through Small Enterprise Development, ILO
ILO	International Labour Organization
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau
JBIC	Japan Bank for International Cooperation
JSB	Joint Stock Bank
MB	Military Commercial Joint Stock Bank
MHB	Mekong Housing Bank
MIS	Management Information System
MOJ	Ministry of Justice
MPDF	Mekong Project Development Facility
MSE	Micro and Small Enterprise
NBCI	Non-Bank Credit Institution
NFHE	Non-Farm Household Enterprise

NGO	Non-Governmental Organization
NPL	Non-Performing Loan
ODA	Official Development Assistance
Oricom	Oriental Joint Stock Commercial Bank
PCF	People's Credit Funds
PNB	Phuong Nam Bank
ROE	Return on Equity
Sacombank	Saigon Commercial Bank
SBV	State Bank of Vietnam
SFP	Social Finance Program, ILO
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprise
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprise
SIYB	Start & Improve Your Business
TA	Technical Assistance
TCB/TechcomBank	Vietnam Technological and Commercial Joint Stock Bank
USD	United States Dollars
VAT	Value-Added Tax
VBARD	Vietnam Bank for Agriculture and Rural Development
VBP	Vietnam Bank for the Poor
VCCI	Vietnam Chamber of Commerce and Industry
VIB	Vietnam International Bank
Vietcombank	Bank for Foreign Trade of Vietnam
VND	Vietnam Dong
VPBank	Vietnam Bank for Private Enterprises
WB	World Bank

EXECUTIVE SUMMARY

Introduction

The private sector, especially small enterprises, has demonstrated to be the engine of growth and employment for emerging and developing economies alike. In Vietnam, the enactment of the Enterprise Law in 2000 has resulted in a burgeoning private sector. By November 2003, there were a total number of 120,000 private enterprises and 2.5 million household enterprises operating in the country. Of these, 95% of the private enterprises are Small and Medium Enterprises (SMEs) while 50% of are Micro and Small Enterprises (MSEs). Both sectors have contributed to 48.5% of the country's GDP.

Since 1998, the International Labour Organization (ILO), in collaboration with the Vietnam Chamber of Commerce and Industry (VCCI), has been implementing the Start & Improve Your Business (SIYB) program. This training program aims at addressing the needs for basic business management skills in the Micro and Small Enterprise (MSE) sector and to increase income and employment creation in MSEs. Impact studies carried out by the program in Vietnam show that the SIYB program leads to significant business start up and employment creation. The studies also show, however, that one of the constraints often mentioned by SIYB graduates, and by Vietnamese MSEs in general, is the lack of access to credit and other financial services from the banking sector.

This study has been commissioned by the ILO in order to examine the supply of formal financial services to MSEs in the urban areas of Ha Noi, Ho Chi Minh City, and Can Tho. The objectives of the study are three-fold: (i) to provide a comprehensive and updated overview of the financial services market for MSEs, (ii) to understand the constraints and barriers in providing financial services to MSEs, and (iii) to gauge commercial banks' interest in serving this sector. This study seeks to identify commercial banks with which Business Development Services (BDS) providers, including the SIYB program in Vietnam, could establish a strategic linkage to facilitate access to financial services for this under-served urban segment.

Characteristics of MSE Credit Demand

The non-state sector in Vietnam comprises four groups of enterprises: household enterprises (HEs), private domestic companies, cooperatives, and FDI-funded companies. This report focuses on household enterprises and the lower end of the small private enterprises due to the following reasons:

- Of the 120,000 registered private enterprises and 2.5 million household enterprises, about 50% (about 1.3 million) are considered to be MSEs that employ from 6 to 30 employees.
- The non-state sector contributes over 60% of total GDP, of which MSEs contribute around 26%.
- MSEs have shown to be an important vehicle for job creation, accounting for 30% of total salaried employment in the private sector.

In their start-up and expansion phase, MSEs need to borrow substantially to finance their investment and working capital requirements. The loan can be utilized either to buy additional inputs or raw materials, to purchase a fixed asset such as equipment or building, or to diversify into a related complementary business. An average micro enterprise would seek a loan between VND 5 million and VND 100 million (USD 300-6,500) while a small enterprise would seek a loan of between VND 100 million to VND 500 million (USD 6,500-30,000).

A typical MSE's borrowing behavior can be characterized by: (a) low willingness to share information; (b) high priority towards cash-based transactions; (c) inadequate borrowing skills, (d) insufficient historical track record; (e) insufficient collateral; (f) willingness to accept a relatively high interest rate; and (g) high priority towards banking convenience.

While a precise level of credit access by MSEs is hard to pinpoint, results of past surveys have indicated that (a) access to financial resources represents one of the top difficulties stated by MSEs and (b) MSEs tend to rely on funding from family and friends for credit. In addition, a recent study by the IFC found that in 2002, granted credit volume from commercial banks could only serve 11% of the total financing requirement of the non-state sector. These findings seem to indicate that the demand for credit by MSEs is far from being met.

Constraints to MSE Lending

Results from this study's survey show that different perceptions exist about barriers facing MSEs in accessing formal finance. Overall, respondents consider the highest constraint to be insufficient borrower information, followed by insufficient collateral, and MSEs' qualifications. However, Joint Stock Banks (JSBs) and State-Owned Commercial Banks (SOCBs) differ in their assessment of the institutional readiness to serve MSEs. Joint Stock Banks view the higher transaction costs, the design of appropriate products, and the acquisition of additional resources as relatively low barriers, while the State-Owned Commercial Banks view transaction costs and internal capacity to be significant barriers.

During in-depth interviews with banks, JSBs stated that the main reason why they often count on collateral requirements is because of the difficulty in legally enforcing contracts and in using the judicial system to pursue bad loans. SOCBs, on the other hand, did not rate the judicial system to be a particular significant constraint. Rather, they mentioned the difficulty in obtaining accurate information from borrowers and high transaction costs as the key barriers to serving the MSE market.

Some additional issues in terms of barriers to MSE lending include:

- ***Taxation Regime***. The complicated and punitive tax framework discourages many household enterprises to be transparent about their operations and revenue information.

- ***Inadequate judicial system***. The formalities for pursuing bad loans can be very cumbersome and the court usually expects the lender to prove that it has taken every step possible to recover the loan before judicial procedures can be started.

- ***Lack of centralized market and industry information***. Some limited information on individual enterprises is collected by the Credit Information Center (CIC) but this information does not always exist for the MSE segment.

- ***Lack of standardized procedures and products for MSEs***. SOCBs and JSBs interviewed in this study tend to use the same credit analysis procedures for smaller loans as for big corporate loans. Not all banks have tried to adjust their existing procedures to take into account the additional risks involved in serving MSEs. In addition, no banks are offering a credit product that is tailored for the lower segment of the market hence staff productivity remains low.

- ***Culture of Non-Compliance***. There is the prevalent perception among MSEs that by staying informal or staying small on paper, businesses can avoid paying higher taxes. This lack of transparency in reporting results in a sense of distrust or suspicion between clients and lenders.

- ***Informality of transactions and bookkeeping***. The majority of MSEs still conducts most of their business transactions outside the banking system. As a result, the type and level of documentation that a bank receives from a MSE are often inadequate, not readily available, or at times non-existent.

Current Players in MSE Lending

The lending market appears to be segmented by type of institution. In 2002, nearly 50% of the loan portfolio of SOCBs was channeled to SOEs. Of the total credit supply of VND 230 trillion (USD 15.3 billion), only 40% is granted to the non-state sector. According to the study's calculation, as of 2002, total credit supplied to non-state sector is about VND 85 trillion (about USD 5.7 billion). Five SOCBs (Vietcombank, VBARD, Incombank, BIDV and Mekong Bank) have a market share of 80% and the remaining JSBs have a market share of 20%.

In the rural region, the dominant financial institution is the Vietnam Bank for Agriculture and Rural Development (VBARD) with its 1,568 branches over the country. The second important player in rural finance is the People Credit Fund's system with its 950 People's Credit Funds (PCFs) country-wide.

Of the total credit supply, VBARD alone offered VND 42 trillion (USD 2.8 billion) to household farmers in rural areas. Putting aside this amount, the total market size for the non-state *urban* sector is estimated to be less than VND 43 trillion (USD 2.9 billion). As a result, the relative proportion of JSBs market share in non-state *urban* lending would increase from 20% to above 64%. In short, SOCBs (excluding VBARD) and urban JSBs are the two main formal credit suppliers for private MSEs operating in urban cities, with JSBs holding a larger market share than SOCBs.

Banks' Perception of MSEs

In general, the JSBs show stronger motivation and have more experience than SOCBs when it comes to MSE lending. The current situation of banking for MSEs in Vietnam can be summarized as follows:

- ***Attitude towards MSEs lending.*** JSBs have a more positive attitude towards MSEs as compared to SOCBs. The study's survey results show that 70% of JSBs view the banking market as being very competitive but only 50% of SOCBs did so. This indicates that JSBs perceive a need to find a niche market such as MSEs. In addition, JSBs positioned the role of the MSE segment as "very important" and "important" to their business while SOCBs, with the exception of VBARD, said that MSEs are either "not important" or "partly important."

- ***MSEs lending skills***. JSBs are more skillful in lending to MSEs and tend to rely more on alternative methods of information collection for their credit analysis. Credit officers of SOCBs may be better at analytical skills, but they lack communication skills and strong motivation to go downscale to this sector.

- ***Simple and Lean Lending Procedures.*** JSBs appear to have more flexible and transparent lending procedures towards MSEs. Some JSBs explain to customers the questions bankers will ask borrowers in the interview meeting and the standardized forms for loan request. In addition, explanations of repayment plan are written in simple language, and are made available in user-friendly format. Some banks have decentralized their credit approval process by granting loan approval rights (up to a certain loan size) to a specified individual, without having to go through a credit committee. Some JSBs have also created their own credit scoring system in order to measure the creditworthiness of borrowers and streamline the credit process.

- ***Collateral management***. JSBs appear to be more flexible in evaluating collateral, with the majority of banks using a combination of the official government valuation and an internal market-based valuation. The range of acceptable collaterals and the process of managing collateral are also more diversified in a JSB.

- ***Branch network***. SOCBs have a wider branch network than JSBs partly due to the discriminatory regulation of the SBV, which restricts the ability of JSBs to open branches. However, JSBs do possess an adequate network coverage in the urban areas that are the target of this study.

Identifying Candidate Banks

In terms of assessing where banks would like to go in the future, i.e. their strategic vision, the study found that (i) most JSBs do have a strategy to serve MSEs; (ii) urban JSBs traditionally serve urban MSEs, but rural JSBs are expanding to urban areas and are able potentially to serve urban MSEs; and, (iii) northern JSBs tend to lend to companies more than to individuals, while the reverse trend can be seen among southern JSBs.

In terms of bank capacity, Asia Commercial Bank (ACB), East Asia Bank (EAB), and Saigon Commercial Bank (Sacom) are expected to maintain their current high performance in the next few years. Sacombank may play an important role in the MSE market due to its clear focus on credit and near-credit activities. ACB and EAB will still benefit from their non-funded activities such as cards, remittances, international trade transactions[1], etc. As a result, a proactive strategy and business plan towards MSEs are not guaranteed. Vietnam Bank for Private Enterprises (VPBank) is expected to improve its performance substantially. The majority of its past Non-Performing Loans (NPL) will be restructured, and the balance sheet will be cleaned. Given its strong leadership and clear focus on MSEs, this bank may play an important role in this segment.

In terms of financial performance, EAB and ACB seem to be the best banks in managing costs due to their development in non-funded business such as cards, international trade transactions and remittances. Both banks have a wide branch network, a relatively low NPL, and an established quality management system. However, because they are the market leaders, they have had no need to proactively search for new customers or to go more downscale. Sacombank and VPBank have strong leadership who want to do business with MSEs, and skillful and proactive staff who are motivated to go downscale. Sacombank is more ahead of VPBank in terms of expanding its network and procedures to lend to MSEs, but the latter is in a turnaround process in which remarkable achievements should be recognized.

From a developmental perspective, if a donor wishes to ensure that its intervention will have maximum impact in the short-term, it should seek out smaller and promising banks, or the "rising stars." While ACB and EAB are certainly the leaders in its sector and have received much donor attention in the past few years, there is a risk that too much donor intervention will result in a market where a few highly-favored banks will dominate the market at the expense of other banks. In short, in an effort to optimize the impacts of donor's money, MSE-oriented and MSE-friendly banks such as Sacombank and VPBank would be promising candidates.

Conclusion & Recommendations

The findings from this study showed that JSBs consider internal organizational constraints to be the barriers that could be most easily overcome in MSE lending. These include the development of MSE-responsive products, implementation of appropriate structures and systems, and training of professional staff on the particularities of MSE lending.

At the same time, donor interventions in MSE lending should be consistent with the overall banking sector reform agenda at the national level. For this reason, a two-tier approach containing a comprehensive **training program** to several institutions that will contribute to the strengthening of the overall sector, combined with a tailored and **intensive technical assistance** program and a **line of credit** to one or two institutions, is recommended in this study.

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[1] Such as Letter of Credit, Documents against Acceptance, Documents against Presentation and Telegraphic Transfers.

On the first level, the sectoral level, the donor would be able to work with a broad number of banks who have shown genuine interest in MSE lending. Staff training is one of the key elements in building a strong and healthy bank. Participation in training also offers staff the opportunity to network with their peers and helps to solidify the professional association among banks. This intervention will consist of a focused and tailored training for credit managers and credit officers working with MSEs, covering the basics of credit analysis as well as providing concrete cases/examples in how to adapt credit analysis process to this segment.

On the second level, a line of credit would be provided as incentives for banks who may not be sufficiently capitalized to expand their lending to the MSE market. The line of credit should be paired with intensive technical assistance to ensure the effective utilization of funds and sustainability of the intervention. The line of credit should be disbursed based on strict performance criteria related to targeted clients and portfolio quality. The technical assistance should focus on implementation of systems and procedures that are appropriate to this segment, and should have a goal to reinforce the infrastructure of the bank. Interventions should cover aspects such as MSE product development, risk management procedures, client assessment and monitoring, staff training and incentives, etc.

The technical support package proposed in this study aims to maximize staff productivity, minimize transactional costs, mitigate credit and institutional risk, so that banks can maintain profitability while lending to MSEs. In addition, the availability of quality training to a larger group of institutions will ensure that banks' MSE lending capacity will be increased and will contribute to the safety and soundness of the overall banking sector.

I. INTRODUCTION

The private sector, especially the small enterprises sector, has demonstrated to be the engine of growth and employment for emerging and developing economies alike. In Vietnam, the enactment of the Enterprise Law in 2000 has resulted in a burgeoning private sector. As of November 2003, there were a total number of 120,000 private enterprises and 2.5 million household enterprises operating in the country. Of these, 95% of the private enterprises are Small and Medium Enterprises (SMEs) while 50% of are Micro and Small Enterprises (MSEs). SMEs and MSEs combined have contributed to 48.5% of the country's Gross Domestic Product (GDP).[2]

Since 1998, the International Labour Organization (ILO), in collaboration with the Vietnam Chamber of Commerce and Industry (VCCI), has been implementing the Start & Improve Your Business (SIYB) program. This training program aims at addressing the needs for basic business management skills in the Micro and Small Enterprise (MSE) sector and to increase income and employment creation in MSEs. Over the last four years, the SIYB project and its 80 active Partner Organizations have trained more than 18,000 potential and existing entrepreneurs in the Start Your Business (SYB) and Improve Your Business (IYB) program in 40 provinces.

Impact studies carried out by the program in Vietnam show that the SIYB program leads to significant business start up and employment creation. The studies also show, however, that one of the constraints often mentioned by SIYB graduates, and by Vietnamese MSEs in general, is the lack of access to credit and other financial services from the banking sector. It is now widely acknowledged that business management training has more impact if credit is also provided, so even though the SIYB program is proven to lead to employment creation, the impact would be higher if entrepreneurs had better access to credit as well.

Therefore, the ILO's SIYB program in Vietnam together with the Social Finance Program (SFP), the InFocus Program on Boosting Employment Creation through Small Enterprise Development (IFP/SEED) both based in the ILO headquarters in Geneva, and the ILO Office in Vietnam, has commissioned two studies to assess the demand for and supply of formal financial services to MSEs. The studies focus specifically on the urban areas of Ha Noi, Ho Chi Minh City, and Can Tho. This particular study focuses on the supply side of financial services, while the other study focuses on the demand side.

Urban-based MSEs represent an untapped market in Vietnam and as experiences in other countries in the region have shown, commercial banks who have the strategic vision and commitment to target this niche segment are seen as pioneers and innovators in their country. In Indonesia, Bank Rakyat Indonesia (BRI)'s Unit Desa has demonstrated that with a proper structure and procedures, and a right mix of products, lending to MSEs can be done on a financially sound and profitable basis. In fact, in the aftermath of the Asian Financial Crisis in 1997, it was the Unit Desa department of the BRI that helped to prop up the rest of the bank as a substantial number of BRI's corporate loans became non-performing. Similar successes in MSE lending can be seen at CARD Bank in the Philippines and ACLEDA Bank in Cambodia.

[2] Pham Chi Lan, "Private sector development –a long and challenging road"; Manager Magazine No.5, November 2003.

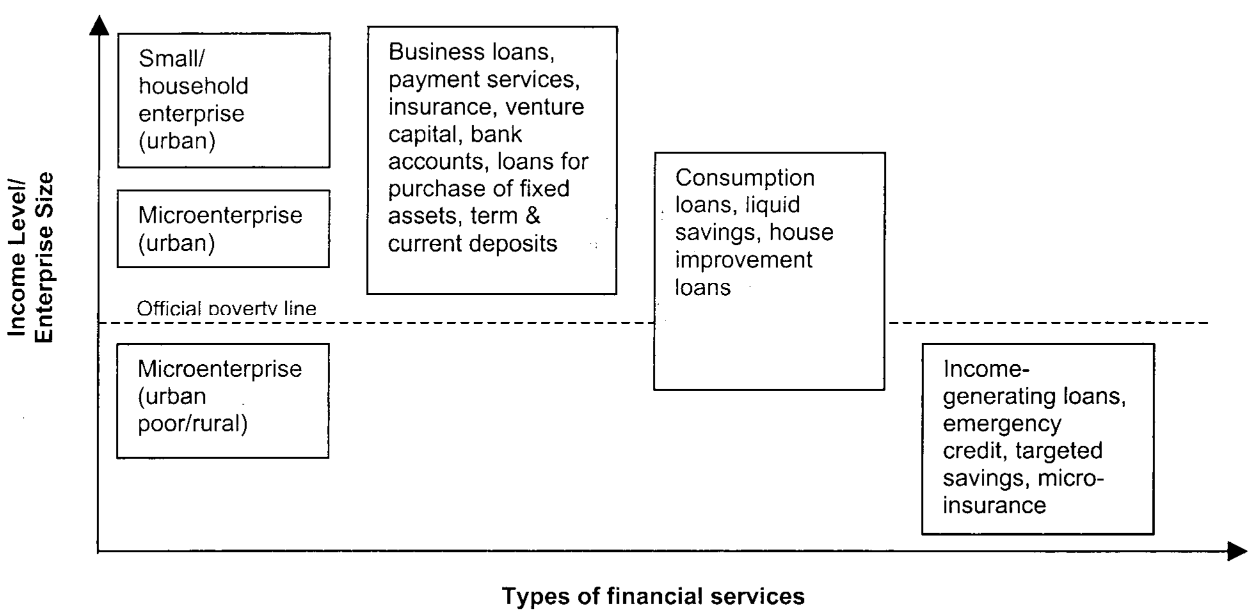
A. Objectives & Scope of the Study

The objectives of the study are three-fold: (i) to provide a comprehensive and updated overview of the financial services market for MSEs, (ii) to understand the constraints and barriers in providing financial services to MSEs, and (iii) to gauge commercial banks' interest in serving this sector. This study seeks to identify commercial banks with which Business Development Services providers, including the SIYB program in Vietnam, could establish a strategic linkage to facilitate access to financial services for this under-served urban segment.

This study focuses on commercial lending to private micro and small enterprises, including non-farm household enterprises (NFHEs), in the urban areas. Microlending or microfinance in Vietnam has often been viewed as poverty lending, i.e. lending to the working or productive poor. While this is certainly true in rural areas, where access to a small loan can make a significant impact in raising the income-generating capacity of a poor household, urban-based MSEs have different characteristics and hence different needs for financial services than those in rural areas.

As the chart below demonstrates, there exists a range of financial services demanded by micro and small enterprises depending on their size and income level. Financial service providers must thus adapt their offerings to each market segment in order to meet these diversified needs. This study will focus on the shaded part of the diagram—commercial financial services for the purpose of managing and growing an established urban-based enterprise.

Figure 1. MSEs and Financial Services Needs



B. Research Methodology

The researchers used a two-step approach in collecting information for this report. First, the team sent a structured questionnaire to 39 joint-stock banks (JSBs), 5 state-owned commercial banks (SOCBs), 2 policy banks[3], 5 non-bank credit institutions (NBCIs), the Central People Credit Fund, 17 donor institutions, 5 supporting/intermediary organizations (including the State Bank of Vietnam), and 5 current MSE lenders (i.e. Microfinance Institutions). The questionnaire surveyed respondents about their understanding and perception of the current market situation for private sector lending, specifically MSEs, and the major constraints that

[3] Social Policy Bank and Development Assistance Fund.

face MSEs in accessing formal financing. For commercial banks, the team also sought information on the banks' strategic direction in the coming five years, their market segmentation and priorities, as well as the products currently being offered.

A total number of 30 responses were received, amounting to a 38% response rate.[4] The types of respondents are broken down as follows:

Institutional Type	Number
International donor institutions	7
State Bank of Vietnam	3
State-owned commercial banks	3
Joint-stock banks	11
Other credit institutions*	3
Supporting organizations†	3
Total:	30

* Include current MSE lenders, People's Credit Fund, leasing companies.
† Include research institutions, BDS providers, and advocacy organizations.

Secondly, the team conducted in-depth interviews with a selected number of joint-stock banks, 4 of the 5 state-owned commercial banks, the SBV, and donor organizations in the three target cities. In the interviews with the banks, the team aimed to obtain more detail on the institutions' strategic orientation, operating structures, and credit procedures in order to determine which banks have the commitment to go downscale and have the capacity or the most potential to service a high-volume loan portfolio. The team also met with different international donor organizations, bilateral and multilateral, who have been working in private sector development, to understand their current and future interventions in this domain, and to explore possibilities of collaboration in increasing commercial bank lending to MSEs. Finally, the team met with representatives of the SBV, including the Credit Information Center, to better understand the legal and policy environment facing MSE lenders.

[4] A number of Joint Stock Banks based in Can Tho did not respond to this survey due to ongoing merger/consolidation negotiations with other banks. In addition, surveys were sent to individual branches in the three target cities but responses were usually received from the head office.

II. COUNTRY BACKGROUND

A. VIETNAM MACROECONOMIC ENVIRONMENT

In the Vietnam Development Report 2004, the World Bank estimates Vietnam's economic growth for 2003 to be around 7 percent, making it the world's fastest growing economy after China. Similar growth rates appear to be sustainable in the medium term. The sustained economic expansion is driven by export and buoyant domestic activity. The total Gross Domestic Product (GDP) was VND 536,098 billion (USD 34.5 billion) in 2002[5]. From a sectoral perspective, the domestic private sector has been growing fastest, contributing 62% of total GDP and accounting for 2.5 million jobs.

The level of exports grew by an overall 11% in 2002, most of which consisted of increased sales to the United States as a result of the Bilateral Trade Agreement (BTA). Exports to the US increased by 128% and accounted for 82% of total export growth in 2002, effectively making the US Vietnam's largest export market.[6] The value of agricultural exports also experienced an increase partly due to volume but mostly due to the rising price of some important commodities.

The improving private sector climate has not only resulted in an increasing number of new business registrations, it has also encouraged additional foreign direct investments (FDI) into the country. Foreign investment inflows rose by 10% in 2002 and this level is expected to be sustained in 2003 to comprise 3.5% of GDP.[7] The level of banking credit growth also continued to expand at a level of 22.5% in 2002, with credit to the non-state sector growing faster at 29.3% per annum[8].

Vietnam's spectacular growth performance has been made possible by sound macroeconomic management. After a period of economic turbulence, following the collapse of the former Soviet Union, Vietnam has managed to keep a low inflation rate, a moderate budget deficit, and a sustainable level of public debt. The Inflation rate remained steady at 4.3 percent. This inflation level reflects the higher price for food, specifically rice, and the higher domestic demand for construction materials.

The growth performance has also been based on a systematic unleashing of market forces. The distribution of land-use rights to households in agricultural areas, the gradual liberalization of international trade, and the legal regime to register new enterprises have been among the most significant milestones in this process. On the structural front, the policy area where reforms are most advanced is the integration with the world economy. The recent decision by the Government to try to join the World Trade Organization confirms its commitment to increased openness.

Vietnam's economic structure remains dominated by State-Owned Enterprises (SOE). Since 1992, Vietnam dramatically reduced the number of SOEs from 12,000 to 5,200. A more ambitious divestiture program was adopted in 2003 and should lead to the equitization, sale, or liquidation of another 2,200 SOEs over the next three years, with nearly 3,000 SOEs remaining by 2006.[9]

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[5] From this point forward, one USD is equal to VND15,500 in our calculations.
[6] IMF, Vietnam: Selected Issues, IMF Country Report No. 03/381, December 2003.
[7] World Bank Economic Brief, April 2003.
[8] SBV Annual report, 2002
[9] World Bank, Vietnam Development Report 2004: Poverty, Report No. 27130-VN, Washington, DC: 2003.

Table 1. Shares of State and Private Sector in Vietnam's Economy

	1997	1998	1999	2000	2001	2002
GDP	-					
State	40.5	40.0	38.7	38.5	38.4	38.3
Non-State [a/]	59.5	60.0	61.3	61.5	61.6	61.7
Industrial output						
State	48.0	46.3	43.4	41.8	41.1	40.1
Non-State	52.0	53.7	56.6	58.2	58.9	59.9
Banking credit						
State [b/]	53.0	57.3	49.5	44.7	42.8	41.0
Non-State	47.0	42.7	50.5	55.3	57.2	59.0

a/ The non-state sector includes household enterprises, the domestic private sector, cooperatives and mixed enterprises, as well as foreign direct investment (FDI).
b/ Banking credit to the Government is included in the State sector.
Source: World Bank Vietnam Development Report 2004.

As the table above shows, there has been a gradual decline of the State share of economic activity in the past decade. While industrial production by SOEs has expanded at 11 percent per year on average over the past five years, it is still less than the 18 percent expansion that was recorded by both the foreign-invested companies and domestic private enterprises during the same period. But overall, Vietnam would not have grown the way it did if the state sector had not increased its efficiency. Efficiency gains were due in large part to increased competition in the markets for goods and services and, to a lesser extent, to the hardening of the budget constraints faced by SOEs.

Explicit subsidies to SOEs have been removed, and policy lending has been consolidated under specialized institutions such as the Bank for Social Policies (BSP, formerly Vietnam Bank for the Poor). Still, the servicing of debts by SOEs is uneven, to the point where some 15 percent of all bank loans could be non-performing.[10] New loans are allegedly subject to better assessment of credit risk, but this improvement is happening at a slow pace. The inability to decrease policy lending to SOEs would imply that a portion of today's economic growth will have to be devoted, sooner or later, to clearing bad debts and protecting the solvability of financial institutions.

B. PRIVATE SECTOR DEVELOPMENT

In 2000, Vietnam enacted the Enterprise Law, which provided for the establishment, management, and operation of all types of enterprise (i.e. limited liability, joint stock, partnership, and private enterprises). The Law abolished many of the requirements of previous legislation and replaced a complicated licensing system for new companies with a one-step registration process. In principle, the Enterprise Law aimed to change the role of the government from that of regulator whereby it limits and directs the number and level of private sector activities, to that of facilitator where it sets the ground rules and legal and regulatory framework that provides the enabling environment for the private sector to operate.

The impact of the Law could be evidenced by the number of newly registered enterprises since the year 2000. According to Vietnam's Ministry of Planning and Investment (MPI), over 72,600 domestic private businesses registered for operation from early 2000 to July 2003. This represents a 1.6 time increase over the 1991-99 period. Vietnam currently has 120,000 registered private businesses and their investment comprised 27 percent of gross investments in 2003, compared to 20 percent in 2000 when the Enterprise Law was passed.[11]

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[10] International Monetary Fund, *Vietnam Country Report*, 2003.
[11] *Vietnam News*, November 4, 2003.

Despite this remarkable accomplishment, more could be done in order to produce a level playing field for Vietnam's private entrepreneurs. Among some main issues to be addressed are:

- There exist **too many legislations, regulations, and decrees** governing the activities of private enterprises. While the Enterprise Law has simplified the registration process, additional legal documents have been issued since 2000 which have imposed conditions on capital requirements and other entry restrictions. Moreover, these laws are still subject to local officials' interpretation which leads to an uneven and unpredictable implementation at the local level.
- As a result of Vietnam's **complicated tax framework**, many household enterprises choose to retain their semi-formal status instead of formally registering. Vietnam's Value-Added Tax (VAT) is one of the lowest in the Asia region, at 10% compared to 17% in China, yet because the VAT is imposed on all types of purchases no matter the value of the goods, the effective rate of taxation is one of the highest in the region. The same is true for corporate income tax, where the effective rate is much higher compared to other countries in the region due to the fact that all gains and incomes are taxable while not all expenses are tax deductible or subject to a cap. In addition, companies that earn a return on equity (ROE) in excess of 20% are subject to a surcharge of 25%.[12] Consequently, these measures represent a disincentive for companies to grow and become transparent. There are cases where after three years, entrepreneurs would shut down their business and re-register under a different name in order to go back to paying a lower tax level in the first year.
- **Access to land and capital** remains difficult as preferential treatment continues to be given to state-owned enterprises. In addition, complex land entitlements and land use right procedures, especially for investment and production purposes, are subject to interpretation by local government offices. Consequently, private enterprises tend to rely on personal and/or family connections to access these key factor inputs.
- The government needs to develop key institutions that form the basis of a functioning market economy. These include a **legal and judicial system** that protects property rights, ensures contract enforcement, and prosecutes fairly those who violate the laws.
- Many Vietnamese entrepreneurs lack the professional capabilities and skills to manage and expand their business. Yet the **market for Business Development Services** (BDS) for private enterprises is still at a nascent stage both on the demand and supply side. Many private enterprises tend to rely more on in-house business services and are not willing to pay for consultancy services or for business management training. On the supply side, a mix of non-governmental, private, and state-funded organizations exists but sometimes results in a fragmented offering of services.

[12] Stoyan Tenev, Amanda Carlier, Omar Chaudry, and Quynh Trang Nguyen. *Informality and the Playing Field in Vietnam's Business Sector*. IFC, World Bank, and MPDF. Washington, D.C.: 2002.

III. THE MSE SECTOR AND ITS DEMAND FOR CREDIT

A. SIZE & CHARACTERISTICS

According to the World Bank, a vast majority of the working-age population of Vietnam is employed, and labor market participation rates are among the highest in the world. In 2002, 85% of men and 83% of women between the ages of 15 and 60 were economically active. Over the last four years, the composition of employment has changed with the proportion of farm self-employment dropping from almost two thirds to slightly less than half. Instead, many more are now engaged in wage employment: 30 percent of those at work earned a wage in 2002, compared to 19 percent four years earlier. By 2002, the formal private sector accounted for around 2.5 million jobs and it is estimated that a larger number of jobs have been created by the private informal sector.

The non-state sector in Vietnam comprises four groups of enterprises: household enterprises (HEs), private domestic companies, cooperatives, and FDI-funded companies. Household enterprises, especially those in urban areas, play an important role in a country's economic transition time, when agriculture is declining in importance but before the formal industrial and services sector is large enough to fill the gap. HEs in urban areas may often represent the sole source of income for many families, whereas in rural areas households depend on multiple revenue sources.[13]

Household enterprises are governed by Decree No. 2/ND-CP, 2000, which requires them to register their business and pay business tax obligations. Nevertheless, because they are not granted the same legal status as officially registered private enterprises, they are considered as belonging in the semi-formal sector. According to the VCCI, there were 2.5 million HEs in 2003, with each HE employing an average of 6.3 persons. The majority of HEs are engaged in the services and retail sectors.[14]

In terms of small enterprises, Decree No. 90/2001/CP-NDD defines them officially as:

> *"...independent business and production establishments that have registered their business under the current legislation and have a registered capital of less than VND 10 billion [USD 640,000] or an average number of annual employees of less than 300."*

This report will focus on household enterprises and the lower end of the small private enterprises as defined in the following table.

[13] Wim Vijverberg & Jonathan Haughton. *Household Enterprises in Vietnam: Survival, Growth, and Living Standards.* 2001.
[14] Pham Thi Thu Hang, *Creating a Conducive Environment for Employment Creation in Small Enterprises in Vietnam*, ILO/SEED Working Paper No. 31, 2002.

Table 2. Study's Definition of MSEs

Type	Number of Workers	Legal status	Monthly revenue/sales	Loan size	Sectors
Micro	1-9	Informal, semi-formal/ household	VND 4-40 million (USD 250-2,500)	Minimum VND 5 million, maximum VND 100 million (USD 300-6,500)	Services, light manufacturing, small retail
Small	10-49	Formally registered	VND 40-200 million (USD2,500-13,000)	Minimum VND 100 million, maximum VND 500 million (USD 6,500-30,000)	Services, manufacturing, retail, agricultural production

This particular segmentation was selected because of the following reasons:

- Of the 120,000 registered private enterprises and 2.5 million household enterprises, about 50% (about 1.3 million) are considered to be MSEs that employ from 6 to 30 employees.
- The non-state sector contributes over 60% of total GDP, of which MSEs contribute around 26%.
- MSEs have shown to be an important vehicle for job creation, accounting for 30% of total salaried employment in the private sector.[15]

B. DEMAND FOR CREDIT

In their start-up and expansion phase, MSEs need to borrow substantially to finance their investment and working capital requirements. Loans are needed to buy additional inputs or raw materials, to purchase a fixed asset such as equipment or building, or to diversify into a related complementary business.

Unfortunately, official data about credit requirements of the MSE segment in Vietnam are not available. However, according to some experts, MSEs usually have a fundamental working capital requirement of up to 25% of their annual revenue. An average micro enterprise would seek a loan between VND 5 million and VND 100 million (USD 300-6,500) while a small enterprise would seek a loan of between VND 100 million to VND 500 million (USD 6,500-30,000).

MSEs' buying behavior as bank borrowers can be characterized as follows:

- ***Low willingness to share information.*** The fear of losing confidential information about customers, production methods to competitors, or real profit number to tax bureaus, leads to a hesitancy by MSEs to disclose complete information to bankers.

- ***High tendency toward cash-based transactions.*** Lack of awareness about banking settlement products and fear of making financial transactions transparent are the main reasons for MSEs to lean toward cash-based transactions. A recent study by IFC/MPDF indicated that 30% of private enterprises settled 80% of their transactions outside of banking system, and more than half of private enterprises settled 60% of their transactions outside of banking system.[16] While these figures apply more to formally registered SMEs, it would be reasonable to assume that the volume of cash-based transactions would be at least equal if not higher among MSEs.

[15] Ibid.
[16] Stoyan Tenev et al, ibid.

- ***Inadequate borrowing skills.*** Lack of understanding about banking lending procedures and lack of knowledge about preparing business plan reduce MSEs' borrowing capacity.

- ***Lack of collateral.*** MSEs often do not have appropriate or sufficient collateral that are commonly accepted at Vietnamese banks such as land use right, house, office, and cars. In addition, MSEs usually do not rely on a formal distribution and/or manufacturing channel for their product upon which it could use as a type of collateral.

- ***Insufficient historical track record.*** Many MSEs are newly established after the entry of the investment law in 2000 and are usually first-time borrowers so often lack a performance track record and credit history.

- ***Willingness to accept relative high interest rate.*** MSEs that need a loan can and will accept to borrow at a higher interest rate. However, the repayment terms and schedule should be flexible.

- ***High priority toward banking convenience.*** MSEs prefer to deal with banks that are nearest to their business location. Being close to the bank helps them to increase trust in bank and reduce transportation cost.

While a precise level of credit access by MSEs is hard to pinpoint, results of past surveys have indicated that (a) access to financial resources represents one of the top difficulties stated by MSEs and (b) MSEs tend to rely on funding from family and friends for credit. As Table 3 shows, the success rate for accessing credit from an entrepreneur's personal network is also higher than from all other sources. In addition, a recent study by the IFC found that in 2002, granted credit volume from commercial banks could only serve 11% total financing requirement of non-state sector.[17] These findings seem to reinforce the fact that the demand for credit by MSEs is far from being met.

Table 3. Credit Demand and Access Rate

Financial sources	Enterprises who Tried to Access (%)	Success Rate (%)
General financial sources	54.5	N/a
State and private banks	24.7	20.2
Government credit funds	8.7	7.1
International projects	1.9	1.3
Family, friends	38.8	38.5
High interest lenders	11.2	10.6
Others	2.6	1.9

Source: ILO/SEED Working Paper No. 31: *Creating a Conducive Environment for Employment Creation in Small Enterprises in Vietnam.*

[17] Stoyan Tenev et al, ibid.

IV. THE BANKING SECTOR AND ITS LENDING SUPPLY

In the past decade, the number of players in the banking sector has expanded to include a variety of institutions. By 2002, there were 39 commercial joints stocks banks (JSBs), 5 state-owned commercials banks (SOCBs), 4 joint-venture banks (JVBs), 25 foreign bank branches, 1 People's Credit Fund (PCF) System, 1 Social Policy Bank, 7 finance companies, and 8 financial leasing companies. [18] Nevertheless, the SOCBs still account for over 70% of the total assets in the system and remain the dominant player in the lending market.

Total credit supply accounted to VND 230 trillion (USD 15.3 billion) or 43% of GDP in 2002. Banks (including SPB and PCF) still play the dominant role in the credit market[19]. The role of leasing companies is insignificant with total credit supply accounted only to VND 2 trillion (USD 134 million) in 2002.[20]

The sector has also shown a moderately rapid deepening in the level of monetization of the economy. The ratio of bank credit to GDP increased from 13% in 1990, to 27% in 1995, to 43% in 2002. In June 2002, the ceiling on interest rates for lending in domestic currency was removed, allowing banks to better price credit risk and hence to extend loans to the emerging private sector.

A. REGULATORY FRAMEWORK

In the past decade, the Vietnamese government and the State Bank of Vietnam have made some important changes to the structure, regulation, and operation of the country's banking sector. The financial system is becoming more market-based with interest rates being liberalized, and policy lending shifted to specialized institutions such as the Bank for Social Policies (BSP) and the Development Assistance Fund (DAF).

The Law on Credit Institutions distinguishes two types of credit institutions: banks and non-bank credit institutions (NBCI). The main difference between these two categories is that banks are allowed to take demand deposits and term deposits with a maturity of up to 1 year, while the latter are not.

Commercial banks and NBCIs are licensed, regulated and supervised by the State Bank of Vietnam (SBV). In practice, the SBV licenses, regulates and supervises only banks, which include credit cooperatives. Rural NBCIs like NGOs or credit and saving schemes operated by social organizations like the Women's Union are not licensed, regulated and supervised by the SBV, even if they take deposits. The types of regulated credit institutions that exist currently are state-owned commercial banks (SOCBs), joint stock banks (JSBs), joint venture banks (JVBs), branches of foreign banks, the People's Credit Funds (PCFs) and their apex unit, the Central Credit Fund (CCF).

Joint Stock Banks have to adhere by the following rules:

- At least 10% of a JSB's charter capital has to be held by the state or a SOE. SOEs and enterprises, in which the state or SOEs have a share in excess of 50%, must not hold more than 40% of a JSB's charter capital.
- A single private enterprise is allowed to hold up to 30% of a JSB's charter capital, and a single individual investor up to 15%.

[18] State Bank of Vietnam: Annual report 2002.
[19] State Bank of Vietnam: Annual report 2002.
[20] Annual reports of the five leasing companies, 2002.

- A single foreign investor is allowed to hold at the maximum 10% of a JSB's charter capital; the maximum allowed share of foreign investors is 30%. Every foreign participation in a JSB has to be approved by the Governor of the SBV and the Prime Minister.
- An urban JSB has to have at least 35 shareholders. A rural JSB has to have at least 25 shareholders.
- The appointments of members of the Board of Directors and its chairman, members of the Controllers Committee and the Chief Controller, the General Manager and his deputy, have to be approved by the SBV Governor.
- The minimum capital requirement for newly-founded JSBs is VND 150 billion (about USD 10 million).

B. PRUDENTIAL FRAMEWORK FOR CREDIT OPERATIONS

Banks and other credit institutions are required to observe prudential ratios for the use of short-term funds for long-term loans, liquidity and capital adequacy. In addition, banks must comply with requirements on large exposure, risk provisioning, foreign exchange position, and deposit insurance:

- A bank may not use in excess of 25% of its short-term mobilized funds to provide medium or long-term loans.
- The ratio of a bank's current assets to its current liabilities must not fall below 1.0.
- A bank must maintain a minimum capital adequacy ratio, i.e. the ratio of risk assets and equity (charter capital plus reserves), at 8%.
- Credit exposure to a single customer is limited to 15% of the bank's own fund.
- Credit institutions are required to classify their loans and other assets. Assets and off-balance sheet exposures are grouped into 4 categories to which different risk-weighing percentages (0%, 20%, 40%, and 100%) are applied. The IMF and WB are currently working with the SBV to introduce IAS (International Accounting Standards) rules for asset classification and provisioning.
- SOCBs and – provided they meet certain conditions – JSBs and Joint Venture Banks are allowed to extend unsecured loans, or loans the value of whose collateral falls short of 100% of the loan amount, to creditworthy customers. If the customer is a registered enterprise, the enterprise must have been profitable in the last two years.
- A JSB has to fulfill the following conditions in order to extend unsecured or partially collateralized loans:

  (a) Its outstanding non-performing loans (NPLs) must account for less than 5% of the bank's outstanding loans. NPLs include overdue but potentially recoverable debt, debt difficult to be recovered, debts pending settlement, and frozen debts which appear on the monthly statements of accounts.

  (b) A JSB must have the minimum charter capital required by law. There is an upper limit on the amount of unsecured or partially secured loans, which is the JSB's charter capital plus its reserve funds.

- There is no collateral requirement for loans smaller than VND 10 million (about USD 660).
- The SBV administers the activities of credit organizations through off-site surveillance and on-site inspections. The Banking Inspection Bureau is the arm of the SBV that performs these functions. Banking supervision is still considered a relatively weak area of the SBV.

C. Market Size and Market Players in MSE Lending

This section provides an estimate of the total credit supplied to non-state MSEs in the urban areas and identifies who are the most active market suppliers in this segment.

1. State-owned versus non-state (private) sector

The lending market appears to be segmented by type of institution. In 2002, nearly 50% of the loan portfolio of SOCBs was channeled to SOEs. Foreign banks are mainly engaged in providing financial services to multinational corporations or international organizations operating in the country. Joint stock banks remain the primary source for serving the domestic private sector, which accounts for the bulk of their market share of bank credit.

The percentage of credit channeled to SOEs has decreased in the past decade and currently comprises around 40% of total credit in the economy. At the same time, however, DAF (Development Assistance Fund) credit to SOEs has increased rapidly so that the combined bank and DAF credit to SOEs as a portion of total outstanding credit is at 46% in 2002, and is projected by the IMF to increase in 2003.

Of the total credit supply of VND 230 trillion (USD 15.3 billion), only 40% is granted to the non-state sector.[21] According to the study's calculation, as of 2002, total credit supplied to non-state sector is about VND 85 trillion (about USD 5.7 billion).[22] Five SOCBs (Vietcombank, VBARD, Incombank, BIDV and Mekong Bank) have a market share of 80% and the remaining JSBs have a market share of 20%.

The main financing source for the non-state sector is the SOCBs (42% of non-state enterprises having obtained loans from SOCBs) and JSBs (28% of non-state enterprises having obtained loans from JSBs).[23]

2. Urban versus rural lending

A demarcation of lending supply also exists in terms of geographic locations. In the urban region, the dominant players are the Bank for Foreign Trade of Vietnam (Vietcombank), the Bank for Investment and Development of Vietnam (BIDV), the Industrial and Commercial Bank of Vietnam (ICBV), and the majority of JSBs.

In the rural areas, the dominant financial institution is the Vietnam Bank for Agriculture and Rural Development (VBARD) with its 1,568 branches throughout the country. Apart from corporate lending to enterprises in the agri-food sector, an important part of VBARD's business is the provision of loans and financial services to rural household enterprises. In 2002, VBARD offered VND 42 trillion (USD 2.8 billion) to household farmers in rural areas. The second important player in rural finance is the People Credit Fund's system with its 950 People's Credit Funds (PCFs) country-wide. VBARD and VBP together have reached about 50% of rural households. Rural JSBs do not play a significant role in rural financing due to their limited branch network and lack of both equity and deposits.[24]

By setting aside the total credit offered to farmers and rural households, the total market size for the non-state *urban* sector is estimated to be less than VND 43 trillion (USD 2.9 billion). As a result, the relative proportion of JSBs market share in non-state *urban* lending would increase from 20% to above 64%.

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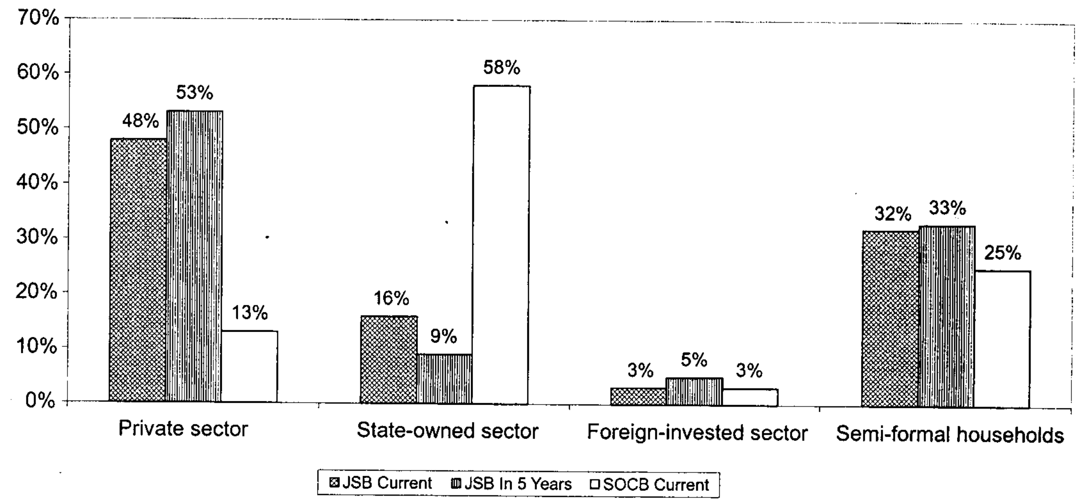
[21] Le Duc Thuy, SBV's Governor in an interview with Vietnam Business Forum , Nov. 2002.
[22] Survey results based on 2002 annual reports of 5 SOCBs, 13 largest urban JSBs and 2 rural JSBs.
[23] Stoyan Tenev et al, ibid.
[24] The largest of the JSBs currently has over 35 branches; this is partly due to the fact that the SBV controls the rate at which a JSB can open new points of service.

In short, SOCBs (excluding VBARD) and urban JSBs are the two main formal credit suppliers for private MSEs operating in urban areas, with JSBs holding a larger market share than SOCBs. Figure 2 provides an illustration of the allocation of commercial bank lending portfolio based on this study's survey.

Figure 2. Allocation of Commercial Bank Lending Portfolio



Source: Study's Survey Results, 2003.

D. PRODUCTS OFFERED TO MSEs

Research from this study found that banks have not yet developed tailor-made products for MSEs but are providing the same products that are offered to larger corporations.

Types of Loan. In principle, MSEs, like all other companies, may have access to the following types of loan products:

- ***Long term financing for purchasing fixed assets***: Loan with a tenor exceeding 5 years, granted for purpose of purchasing fixed assets such as equipment, processing lines, etc.
- ***Project finance***: Long-term loan with a tenor exceeding 5 years, granted for a specific project.
- ***Syndication loan***: Big-size long-term loan with a tenor exceeding 5 years. Several banks cooperate together under the lead of one bank (the arranger) to participate in the financing.
- ***Working capital financing with granted credit line***: Short-term financing with tenor less than 1 year to finance working capital deficit. Credit line is granted only for credible customers, who already established a proven long-term relationship with banks.
- ***Transactional financing (without granted credit line)***: Short-term financing to finance working capital deficit. Loan is granted base on evaluation of a specific transaction such as trading, material purchasing, etc.
- ***Standby credit-(or "call loan")***: Flexible loan facility similar to overdraft lending.
- ***Overdraft lending***: Very short-term financing with tenor less than 1 month to finance shortage of cash. This type of lending is newly introduced to Vietnam.

In reality, however, MSEs usually get finance in the form of transactional lending. In most cases, they are not granted a credit line. Access to project finance or longer-term financing is also very limited. An exception here is that some banks in the South of Vietnam have tried to differentiate themselves by offering pawn loans for MSEs. Those banks include EAB, Saigon Housing Bank, and Sacombank.

Loan currency. Loans are granted mostly in VND and USD. For MSEs and individuals, ACB also offers gold lending[25].

Lending interest rate. Even though MSEs are willing to accept a higher rate, and banks could in fact price their product higher in accordance with borrower risk, this study found that there is no difference between the interest rate offered to MSEs and larger-size companies.

Collateral requirement. This study found that banks are strictly enforcing the collateral requirement when dealing with MSEs. Even though the SBV allows banks to extend unsecured loans up to a certain percentage of their total portfolio, banks have not done so for MSEs.

Collateral such as land, car, processing line, and inventories are accepted. Loans are granted up to a certain percentage of evaluated collateral value (see details in Table 4). This percentage varies from bank to bank depending on the bank's risk appetite and expertise in liquidating such collateral. Another important aspect here is how banks evaluate collateral. When evaluating land, most of the banks look at the government's announced index for this location of land, then compare it with the market price (usually much higher) and make an adjustment. The normal practice is to value a collateral equal to 50%-70% of its market price (already taking the price volatility into consideration).

Table 4: Collateral Requirement

	Loan Value In Relation To Collateral Value	Evaluation Methods
Land	0.5-0.8	Consider both government's announced price and market price +/- price volatility
Car	0.5-0.6	Purchase price less depreciation +/- price volatility
Processing line	0.5-0.8	Market price +/- price volatility
Inventory, stocks	0.3-0.7	Market price +/- price volatility

Sources: Result of interviews with banks.

25 ACB offers gold pawn lending as well as gold lending (i.e. the bank lends gold and the borrower repays gold).

V. GAP ANALYSIS

A. CONSTRAINTS FOR SERVING MSE SECTOR

While the private sector, especially small and micro enterprises, has demonstrated to be the engine of growth and employment for emerging and developing economies alike, granted credit volume from commercial banks could only serve 11% of the total financing requirement of the non-state sector.[26] The following section will analyze the constraints that have hampered the provision of financial services to this particular market segment.

Results from this study's survey show that differing perceptions exist about barriers facing MSEs in accessing formal finance. On a scale of 1 to 8, with 8 being the highest, respondents were asked to rank, using a relative ranking, the significance of the different constraints facing MSEs. The constraints given encompassed the enabling environment, institutional constraints on the part of lenders, as well internal constraints of MSEs themselves.

Table 5. Barriers to MSE Lending

Barrier	Overall	International donors	SOCBs a/	JSBs	Other credit institutions b/	SBV & Supporting organizations
Legal enforcement of contracts	4.44	4.57	4	5.56	4.33	2.40
Perception that not secure, not profitable	3.96	3.86	6	3.33	5.00	4.20
Insufficient borrower information	6.19	5.57	8	6.90	5.00	5.60
Insufficient collateral	5.33	4.29	7	5.67	3.67	5.80
Bank lack of capacity & resources	3.88	5.43	6	3.70	3.00	2.20
Bank products not appropriate	3.38	4.29	1	3.10	2.33	3.80
High transaction costs	4.65	4.57	7	4.50	5.67	4.00
Other:						
MSE lack knowledge of how to apply for loan, business plan, use of funds	5.00	1.00		3.00	8.00	8.00
Unable to pursue bad loans due to poor justice system	8.00			8.00		

a/ Only one of the three responding SOCBs completed this survey question.
b/ Include current MSE lenders, People's Credit Fund, leasing companies.
Source: Study's survey results, 2003.

Globally, respondents consider the highest constraint to be insufficient borrower information (6.19 rating), followed by insufficient collateral (5.33 rating) and MSEs' qualifications (5 rating). If one separates the results by type of institution, however, an interesting difference appears. Joint stock banks and state-owned commercial banks differ in their assessment of the institutional readiness to serve MSEs. The former view the higher transaction costs, the design of appropriate products, and the acquisition of additional resources as relatively low barriers, while the latter view transaction costs and internal capacity to be significant barriers.

As a related question, the survey also asked respondents which of the above barriers would be easiest to overcome, ranking 1 as being easiest and 8 as being most difficult. The results are shown below in Table 6. Globally, insufficient borrower information and insufficient collateral remain the most difficult obstacles to overcome. In this situation too, the responses between SOCBs and JSBs differ.

[26] Stoyan Tenev et al, ibid.

During the in-depth interviews, JSBs stated that the main reason why they often count on collateral requirements is because of the difficulty in legally enforcing contracts and in using the judicial system to pursue bad loans.[27] The SOCBs that were interviewed did not rate the judicial system to be a particular significant constraint. Rather, they mentioned the difficulty in obtaining accurate information from borrowers and high transaction costs as the key barriers to serving the MSE market. This is reflected in their responses to the two questions. SOCBs consider the legal enforcement of contracts to be a moderate constraint, giving it a 4.0 rating but one that is relatively easy to overcome, giving it a 2.5 rating in the second question. JSBs, on the other hand, gave the issue a similar rating in both questions, a 5.56 and 5.73 respectively.

Table 6. Which Barriers Can Be Overcome?

Barrier	Overall	Int'l donors	SOCBs	JSBs	Other credit institutions	SBV & Supporting Orgs
Legal enforcement of contracts	4.71	5.00	2.50	5.73	4.00	3.67
Perception that not secure, profitable	3.67	4.50	4.50	2.70	4.00	4.00
Insufficient borrower information	5.63	4.50	4.50	6.30	5.33	6.17
Insufficient collateral	6.00	5.50	8.00	6.70	4.67	5.33
Bank lack of capacity & resources	3.07	4.67	2.00	2.50	3.00	2.83
Bank products not appropriate	2.67	4.17	1.00	2.00	2.67	2.83
Transaction costs high	4.30	4.83	7.00	3.40	6.33	3.33
Other:						
MSE lack knowledge of how to apply for loan, business plan, use of funds	5.50	1.00		5.00		
Unable to pursue bad loans due to poor justice system	8.00			8.00		

Source: Study's survey results.

Through the in-depth interviews with banks, donor organizations, and the SBV, some additional issues emerged in terms of barriers to MSE lending.

- ***Taxation Regime***. The complicated and punitive tax framework discourages many household enterprises to be transparent about their operations and revenue information. As a result, banks have to rely on the interpersonal skills of their credit officers and are required to spend more time at the business site in order to obtain an accurate image of an enterprise's financial position. In addition, the bank deals with the business rather than the entrepreneur so the fact that some entrepreneurs re-register under a different business name every three years makes it difficult to establish a credit history.[28]

- ***Inadequate justice system***. In interviews, JSBs stated that the formalities for pursuing bad loans can be very cumbersome and the court usually expects the institution to prove that the bank has taken every step possible to recover the loan before it can start the suing process. Many banks feel that the justice system has a natural bias toward the individual over an institution. As a consequence, banks are forced to rely more on collateral requirements in issuing loans.

[27] Banks usually have an internal department in charge of valuating and liquidating collaterized assets or use a trusted external company to carry out this task without having to go through the court system. While the liquidation of land-use rights remains a challenge, banks who accept equipment, inventory/stock, cars, etc. can usually liquidate these collaterized assets without difficulties.

[28] This issue is also related to the internal structure of the bank where corporate lending and consumer lending are considered as separate departments. Individuals who apply for a business loan are handled by the corporate lending department, not necessarily the consumer lending department.

- ***Lack of centralized market and industry information.*** Some limited information on individual enterprises is collected by the Credit Information Center (CIC). However, this information does not always exist for the MSE segment. In addition, several banks had reservations about the accuracy and timeliness of the CIC information (see Section III.D for a more detail discussion of the CIC). As a result, banks have to rely on secondary information in newspapers and trade publications when doing their assessment.[29]

- ***Lack of standardized procedures and products for MSEs.*** In almost all banks, loan officers have insufficient skills for evaluating the financial situation of private firms and the profitability and risk of investment projects, and for monitoring loans. SOCBs and JSBs interviewed in this study tend to use the same credit analysis procedures for smaller loans as for big corporate loans. Not all banks have tried to adjust their existing procedures to take into account the additional risks involved in serving MSEs. This probably explains why some banks tend to rely solely on collateral as the principal means to measure capacity to repay, rather than develop new criteria that would be more appropriate for this segment. The use of cashflow analysis is almost non-existent among banks. In order to manage credit risk, banks should offer credit products that are designed for the different segments of the market. No banks are offering a credit product that is tailored for the lower segment of the market. The current offering is basically the standard corporate loan but at a smaller amount; the terms and conditions have not been adjusted to the risk level nor have they been made uniform to allow for greater credit officer productivity in loan processing and monitoring. As a result, the maximum number of clients each credit officer can oversee is at 50, compared to at least 100 in other countries.[30]

- ***Culture of Non-Compliance.*** As mentioned above, there is the prevalent perception among MSEs that by staying informal or staying small on paper, businesses can avoid paying higher taxes. However, by underestimating their revenue level, businesses are decreasing their ability to access loans from commercial banks since they are undervaluing their cashflow and thus their capacity to repay. Banks also feel frustrated at having little reliable data to work with in their credit analysis. This lack of transparency in reporting then results in a sense of distrust or suspicion between clients and lenders.

- ***Informality of transactions and bookkeeping.*** The majority of MSEs still conducts most of their business transactions outside the banking system. As a result, the type and level of documentation that a bank receives from a MSE are often inadequate, not readily available, or at times non-existent. The issue of informality is a big problem when it comes to documenting a MSE's collateral. For example, a MSE that bought a piece of machinery "informally" would not be able to provide the bank with a receipt or a proof of ownership, the core piece of documentation necessary to use that fixed asset as collateral.

B. MICROFINANCE PROVIDERS

In other developing countries, lending to MSEs started out as the domain of NGOs until commercial banks began to realize the profitability of this segment and began to enter the market. In Latin America, for example, commercial banks have become important providers of microfinance services in the past few years. This "commercialization" of microfinance was seen as a positive development since banks can offer microfinance customers a full range of financial services that are not always available through traditional NGO microfinance providers. Several different models of commercialization exist to date:[31]

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[29] Even for MSEs, banks rely on macro-level information about input prices and commodity prices in order to determine the reasonableness of an enterprise's expenses and revenues.

[30] See Annex D for a matrix of credit products provided by the commercial banks surveyed in this study.

[31] Adapted from ACCION's *InSight* Series, "The Service Company Model: A New Strategy for Commercial Banks in Microfinance," September 2003.

- ***The internal unit/cost center approach***. The downscaling approach involves the creation of an internal unit/cost center or a specialized MSE lending department within an existing commercial bank. The main idea of this model is that commercial banks are able to take advantage of its existing physical and human infrastructure, as well as financial resources, to enter the microfinance market without substantial additional investments or overhead costs. This is the approach used by Bank Rakyat Indonesia (BRI).

- ***The service model approach***. A microfinance service company is a non-financial company that provides loan origination and credit administration services to a bank. The service company does all the work of promoting, evaluating, approving, tracking and collecting loans while the loans themselves are on the books of the bank. In return for providing these credit administration services to the bank, the service company is paid a fee. The service company employs the loan officers and other microfinance program staff, while the bank in turn furnishes services to the service company which could include teller support, human resources, or information technology. The service company can be a wholly-owned subsidiary of the bank or it can involve additional investors. An example is Sogesol/Sogebank in Haiti.

- ***The subsidiary approach.*** Some banks have established financial subsidiaries to serve the microfinance sector. These subsidiaries can be joint ventures with other investors. The financial subsidiary option is attractive when banks and technical experts seek to work together in a transparent and commercial manner without disturbing the operations of the bank. A financial subsidiary is licensed and regulated by the banking authorities and must meet minimum capital and other requirements that go along with the license. Thus, the financial subsidiary requires its own substantial equity capital base. An example is Financiera Solucion in Peru, a subsidiary of Banco de Credito.

- ***The NGO transformation approach.*** Under this approach, a semi-formal financial institution (often an NGO) that is already granting loans to small and micro enterprises receives assistance from a donor or private investors to strengthen the institution to the point that it can become a formal financial institution. Once it has achieved this status, the partner institution will be subject to the same comprehensive regulation by the national banking supervisory agency as other institutions operating in the formal sector. When an existing credit-granting institution is "formalized", the goal is to gradually extend the range of banking products offered by the institution in order to enable small and micro enterprises to obtain access not only to credit facilities but also to payment and deposit services. BancoSol in Bolivia was the pioneer in this approach; another example is ACLEDA in Cambodia.

- ***Building microfinance banks from scratch***. This approach is usually taken when in a given country, neither commercial banks nor other (semi-formal) financial institutions exist which would be willing and able to provide financial services to micro, small and medium enterprises. This approach usually applies in a country that has been involved in a major conflict that resulted in the wiping out of its financial system infrastructure, for example, Cambodia, Kosovo, and Serbia.

In Vietnam, due to the lack of a legal framework for microfinance institutions, the types of providers of financial services to microentrepreneurs consist of international and local NGOs working through social organizations such as Vietnam Women's Union. VBARD and the former Vietnam Bank for the Poor (VBP) are two formal banking institutions with a wide network of branches that serve this segment.[32] Nevertheless, current microfinance lenders tend to focus on rural areas. Those who work in urban areas, for example CEP in Ho Chi Minh City, tend to focus more on lending to poor households and/or disenfranchised clients in

[32] The Vietnam Bank for the Poor used the VBARD branch network to disburse its loans.

poorer areas of the city. Those businesses with formal storefronts or individuals who operate their business from their home are often not served by these lenders. Of the above commercialization options presented, the most feasible in the short-term for Vietnam seems to be either the downscaling option or the service model approach.

C. DONOR INTERVENTIONS IN THE MSE LENDING MARKET

When there is a gap in the demand and supply side of the lending market, donor organizations tend to intervene to ensure a level playing field. The following section is an overview of the types of projects that have been funded by multilateral and bilateral donors in the financial sector, specifically those projects linked to MSE and SME development.[33] It is an illustrative list only and is not meant to be comprehensive.

- **Swedish International Development Agency (SIDA)**

The pioneer in the field of SME finance in Vietnam is the Swedish International Development Agency (SIDA). In 1995, SIDA granted the East Asia Commercial Bank (EAB) a credit line in the amount of USD 1 million for the purpose of extending long-term loans to SMEs. The credit line was used for long-term loans between USD 10,000 and USD 100,000 to SMEs. In most cases the maturity was 2-3 years. By end of 2000, 32 loans totaling USD 2,063,572 had been disbursed. Outstanding loans were USD 722,588. The quality of the loan portfolio is reported to be good, with only 2 problem loans.

- **Japan Bank for International Cooperation (JBIC)**

In 1999, in the framework of Official Development Assistance (ODA), the Japan Bank for International Co-operation (JBIC) concluded a contract with the Vietnamese government on the extension of a loan of JPY 4 billion (about USD 32 million) to the Vietnamese Government for the SME Finance Project (SMEFP). In the framework of this project, the project management unit managed by the SBV extended credit lines to 4 Vietnamese Partner Banks (PBs) for the purpose of onlending to private SMEs, including equitized SOEs in majority private ownership. The credit line was implemented through two SOCBs (ICBV and BIDV), and two JSBs (ACB and EAB). The credit line contained a Technical Assistance (TA) package both for the SBV fund manager SBV and the participating banks.

By September 2003, SMEFP had disbursed USD 7 million in loans to 42 SMEs, with an average loan size of VND 2.5 billion (USD 160,000). The reporting mechanism at the SBV's Project Management Unit tracks amounts disbursed but not default rates of loans so portfolio quality is difficult to assess.

- **Mekong Project Development Facility (MPDF)**

Asian Development Bank (ADB), International Finance Corporation (IFC), Australia, Canada, Finland, Japan, Norway, Sweden, Switzerland and the United Kingdom have set up the Mekong Project Development Facility (MPDF) which promotes the private SME sector in Vietnam, Cambodia and Laos. The MPDF is managed by the IFC. The MPDF has activities in the following fields: provision of technical assistance to SMEs, support to the development of local consultants and business service providers, training of JSB staff in loan analysis techniques, establishment of a bank training centre for JSB, launching of an equity fund for SMEs. The MPDF closely co-operates with ongoing credit line projects by helping SMEs to prepare business plans and investment projects and advising them on financing possibilities with banks and existing SME loan programs.

[33] To obtain the most recent Financial Sector Donor Assistance Matrix, go to http://www.worldbank.org.vn.

- **Asian Development Bank (ADB) & World Bank**

Both the ADB and the World Bank concentrate their financial sector activities on rural finance.

- In 1994 the ADB started a rural credit project which provided refinancing funds in the amount of USD 15.1 million to the VBARD. There was no training of loan officers, but VBARD received some start-up technical support for the management of the program. In 2000, a second project was started which would channel USD 80 million to rural borrowers through VBARD and the PCFs. The second ADB project also contains a technical assistance component for setting up centers for business advisory services in rural areas. In addition, the ADB will provide technical assistance to the SBV for the development of a strategy for microfinance development, and the adjustment of the regulatory and supervisory framework for microfinance.

- The World Bank launched its second rural finance project in 2003 (RDF II). The amount of funds available will be between USD 100 million and USD 180 million. RDF II consists of several components: (a) a fund, at market interest rates, available through the Bank for Investment and Development of Vietnam (BIDV) to accredited participating financial institutions (PFIs) on a short, medium or long-term basis to finance private rural sub-projects that are economically and technically sound; (b) a Micro Finance Loan Fund (MLF), lent by BIDV to microfinance institutions (MFIs) at market rates to provide finance for working capital and small capital investment of micro-enterprises and individual poor people; (c) Strengthening of BIDV's financial performance; and (d) strengthening PFIs and MFIs which will include build up capital base, improve solvency position, profitability, deposit mobilization, and strengthening their related staff capability to implement its various types of rural-finance operations.

- **European Union (EU)**

In the framework of official development assistance (ODA), the European Union has implemented the SME Development Fund (SMEDF). The project was implemented through SOCBs (VBARD, ICB, BIDV) and JSBs (ACB, MB). The funds of the EU have been used to extend long-term investment loans to SMEs ranging from USD 50,000 USD 1,000,000.

The EU is in the process of negotiating with the SBV to launch SMEDF II. The new project is expected to consist of a Euro 20 million Revolving Loan Fund to be administered by DAF, plus a Euro 1 million package for short-term and long-term technical assistance to be implemented by an external consulting firm.

- **Kreditanstalt für Wiederaufbau (KfW)**

KfW is funding a SME credit line through ICBV, through a concessionary loan of Euro 2.5 million with a maturity of 2 years. To date, 1 million Euros have been disbursed. The organization is funding a second credit line through VBARD for a Rural Credit and Savings Program, also through a concessionary loan of Euro 10 million with a maturity of 4 years. To date, the fund has been fully disbursed. An assessment of these two projects has not yet been conducted.

KfW is in the process of designing a new Euro 25 million SME Credit Line that will include a separate window for commercial loans, leasing loans, and loans to the informal sector. A similar model was launched in Cambodia in partnership with MPDF, with a credit line going through ACLEDA Bank.

Impact of Donor Interventions

Donor interventions to date have had mixed results in the expansion of credit to the private sector. If one takes average loan size as an indicator, both the SIDA and JBIC programs seem to have served medium size enterprises rather than smaller enterprises. While this may not be the donor's original intent, the project management system used by the intermediary and/or the participating banks probably was designed to monitor overall fund disbursement and outreach, and did not contain sufficient data to track the size and performance of individual loans. As a result, it was difficult both for donors and banks to evaluate whether loans effectively went to the targeted segment.

In addition, the sustainability of the above programs was not certain since it was unclear whether the participating banks would continue to serve the SME segment. It is also difficult to determine whether the technical assistance provided through these interventions contributed to overall improvement in the bank's operations, including its credit and risk management policies and procedures.

Credit programs for MSEs have tended to focus on rural areas since MSEs are perceived to be informal businesses run by poor households, so that credit provision to this segment would help to improve households' economic situation and help to alleviate poverty. Since the majority of Vietnamese poor households reside in the countryside, this is where donors channeled their development funding. The large number of urban-based household and smaller-scale enterprises has been largely untouched since they are considered to be "better-off" economically and thus have less need for donor intervention. In a way, donors have been taking two different approaches towards private sector development – a *financial systems approach* (i.e. expanding the width and depth of financial services to all segments of the market) towards SMEs and a *poverty alleviation approach* (i.e. encouraging rural development through the provision of credit services) towards MSEs.

D. MARKET SUPPORT INSTITUTIONS

In a developing country where information asymmetries exist, market support institutions are created to facilitate the flow of information to users. The Credit Information Center and the National Collateral Registry represent two initiatives that were implemented by the Vietnamese government in an effort to bridge the information gap about the private sector and MSEs.

1. Credit Information Center

The Credit Information Center (CIC) was initially set up as part of the Credit Department of the SBV and became an independent unit under the SBV in 1999. Its functions include the collection, analysis, forecast, processing, and provision of information on enterprises, as well as other information related to monetary and banking operations to the SBV, credit institutions, foreign and domestic organizations and individuals.

The CIC currently collects client economic records, financial information of enterprises, credit relations, monetary and economic information, and information on foreign enterprises. In 2002, the Center contains data on over 120,000 borrowers with a total of 180 trillion VND in outstanding loans being included in the database. According to the CIC representatives, all commercial banks in the financial system are part of the network and are submitting information on a regular basis through an intranet system. The Center reports that it receives 3,000-4,000 requests for information each month.

Starting January 1, 2004, the State Bank of Vietnam has indicated that businesses will be able to access credit information at a cost. A sample menu of costs is as follows:

- Analysis by industry or other criteria: VND 60,000 (US$3.80) per issue
- Analysis and classification by company: VND 120,000 (US$ 7.70) per issue
- Company financial information: VND 90,000 (US$ 5.80) per issue
- Market information: VND 50,000 (US$ 3.20) per issue

From the banks' perspectives, the most useful information the CIC provides is the outstanding loan balance of an enterprise and/or an individual in the entire banking system. This helps the banks to manage their credit risk more effectively. However, several banks have also indicated that they use the CIC to confirm this particular piece of information, rather than as a primary source, since the level of outstanding loans would be part of their standard procedure when analyzing a loan application. Some banks also questioned the timeliness and accuracy of the information. There have been cases when the outstanding balance listed on the database was out of date, for example, a client has already paid off his obligations with one bank but the information has not been updated on the database.

There is also additional information that banks would like to see in the CIC database. The CIC does not contain complete information on the majority of MSEs, especially household and semi-formal enterprises. In addition, there exists very little information at the sectoral level, for example, performance and price data on the garment industry or the seafood processing industry.

From the perspectives of the World Bank and other donors, the CIC should become more like an independent for-profit credit bureau in the future, focusing on providing credit information to the banking sector and individuals, and devolving the information gathering on industries and enterprises, as well as other aspects of the economy to a third-party organization such as a rating company like Moody's or Standard & Poor's. Essentially, the market for business information services remains under-developed in Vietnam and is an area where private consulting companies could potentially play a role in filling the gap.

2. National Registry for Secured Transactions

In 2001, the Government set up a Registry Center for secured transactions, under the Ministry of Justice (MOJ), aiming at reducing future disputes among creditors on claims on secured transaction with movable assets. The first registered transaction was March 2002, and the Center's scope of operations covers all movable assets with the exception of ships and aircraft. It is hoped that the registration process would increase the transparency of lending transactions and of the ownership of the underlying collateral.

Currently, there are two issues with regard to the Center. First, the Center is not sufficiently technologically advanced to permit electronic filings and access to data. All filings for the entire country are done manually in the central office located in Ha Noi, and all requests for information on liens rely similarly on a manual process. Reportedly, the MOJ is considering on an experimental basis expanding the operation to include registration of liens on land. To be able to effectively handle such an expansion, the Registry Center would need to computerize its operations adequately, and have its present operations running smoothly. Another important improvement would be to allow multiple liens properly prioritized to be provided on the same property. Secondly, banks are not accessing the Registry since they consider the information to be unreliable and incomplete.

VI. BANK POSITIONING TOWARDS THE MSE SECTOR

A. CURRENT BANK PRACTICES IN MSE LENDING

For the purpose of this study, MSEs lenders are defined as formal commercial banks, both state-owned and private. This section will look at how MSEs expect banks to be and will consider how banks serve MSEs currently.

1. Characteristics of a MSE-Friendly Bank

As discussed in the MSE Demand section above, the characteristics of a typical MSE's borrowing behaviors are: (a) low willingness to share information; (b) high priority towards cash-based transactions; (c) inadequate borrowing skills, (d) insufficient historical track record; (e) insufficient collateral; (f) willingness to accept relative high interest rate; (g) high priority towards banking convenience.

Consequently, a MSE-friendly bank should have the following characteristics:

- ***Positive attitude towards MSEs lending.*** MSEs have high priority towards cash-based transactions, so requirements for remittances and bank transfers are limited. In addition, besides traditional lending, they have little need for other bank services such as trade and foreign exchange. As a result, banks focused on doing business with MSEs would rely on interest margin as the main source of income. Therefore, banks would only have a positive attitudes towards MSEs in case they already have competitive advantages in this niche market (being the first mover) or they are under intense competition in other markets (having weak competitive market positioning).

- ***Strong MSEs lending skills.*** MSEs have a low willingness to share information and lack borrowing skills. Official financial information provided by MSEs is often not credible. As a result, lending to MSEs require strong interpersonal skills on the part of credit officers in order to get the relevant credit relevant information from the client. Practical experience of credit officers is also crucial to judge MSEs' creditworthiness and monitor MSE loans after disbursement.

- ***Simple and Lean Lending Procedures.*** MSEs prefer convenience and tend to avoid any form of bureaucracy. As a result, all the standard forms of loan requests, financial plans, etc. should be kept simple. Loan decisions should be made quickly. Banks should be able to balance between risk and return and minimize the use of complicated, multi-level credit procedures.

- ***Flexible collateral management.*** MSEs have insufficient historical track record thus their creditworthiness is difficult to verify. As a result, banks tend to insist on having collateral as a secondary source of repayment.

  Another barrier in this aspect is that MSEs usually have insufficient collateral. Even though lending without collateral is not possible, a MSE-friendly bank should have a flexible collateral policy. This bank should be more open to accept different types of collateral and a mix of different levels of collateral coverage. In order to be effective, a MSE-friendly bank should have a collateral valuation process that is market-based and market-responsive.

  A MSE-friendly bank may consider segmenting its customers according to the level of borrowing skills. Thus, customers who have a solid and clear vision about their business plan and transactions would be graded with higher creditworthiness and would require a lower collateral requirement.

- *Adequate branch network.* MSEs have high priority towards banking convenience, mostly in order to save transportation cost.[34] Since MSEs like to bank near their place of business, a MSE bank should have sufficient branch network to meet MSEs' requirements of convenience.

2. Banks' Perception of MSEs

The characteristics of a MSE-friendly bank can be taken as a base to benchmark with the current situation of banking for MSEs in Vietnam. Findings can be described as follows:

- ***Attitude towards MSEs lending.*** JSBs clearly have a more positive attitude towards MSEs as compared to SOCBs. The main motivation seems to be external factors caused by competitive pressure. In the survey, 70% of JSBs view the banking market as being very competitive but only 50% SOCBs did so.

  JSBs clarified that they are not able to compete with SOCBs and foreign banks, especially after 2008, when the U.S. Bilateral Trade Agreement (BTA) will be fully implemented.[35] Once the market is equally open for every player, all big banks may focus on dealing with blue-chip companies and large-size companies. As a result, JSBs' only choice is to go downscale and focus on the MSEs market, where they have the advantages of being a pioneer and market leader.

  When asked to rate the importance of the MSEs segment in their business, JSBs positioned the role of the MSEs segment as "very important" and "important" while SOCBs, with the exception of VBARD, said that MSEs are either "not important" or "partly important."[36]

- ***MSEs lending skills.*** The initial impression is that JSBs are more skillful in lending to MSEs and tend to rely more on alternative methods of information collection for their credit analysis. Credit officers of SOCBs may be better at analytical skills, but they lack communication skills and strong motivation to go downscale to this sector.

- ***Simple and Lean Lending Procedures.*** The initial impression is that JSBs have more flexible and transparent lending procedures towards MSEs. Some JSBs write down and make it clear to customers about the questions bankers will ask borrowers in the interview meeting. Standardized forms for loan request, and explanation of repayment plan are written in simple languages, and are made available in user-friendly format. Some banks have granted loan approval rights (up to a certain loan size) to an individual credit approver. This will simplify the credit processing activities and increase the accountability of each individual credit approver. Some JSBs have also created their own

[34] Another way of creating bank convenience is to build up an e-banking infrastructure, which allows customers to access to the bank via Internet or mobile network. However, this scenario is far from the realities in Vietnam. In addition, MSEs also prefer to see their bank branches "physically" to build up a personal relationship and trust with them.

[35] On July 13th, 2000, US and Vietnamese negotiators signed a bilateral agreement (BTA). With regards to the financial sector, Vietnam committed to : Ease entry barriers to US financial services providers such as banks and finance companies; Extend MFN Treatment to US; Extend National Treatment to US. The biggest challenges to the Vietnamese Financial Sector may include: (i) losing market share of local banks to US banks due to their competitive disadvantages, and (ii) unfair playing field among foreign banks operating in Vietnam due to unequal treatment between US and non US banks.

[36] In this study, banks were asked to rank the importance of MSEs business on a scale of 1 to 4, 1 being not important, 2 being partly important, 3 being important and 4 being very important.

credit scoring system in order to measure the creditworthiness of borrowers and streamline the credit process.

- *Collateral management*. JSBs appear to be more flexible in evaluating collateral, with the majority of banks using a combination of the official government valuation and an internal market-based valuation. The range of acceptable collaterals and the process of managing collateral are also more diversified in a JSB. For example, some JSBs accept inventory as collateral, and some even rent warehouses or build warehouses to manage and monitor a customer's inventory.[37]

- *Branch network*. SOCBs have a wider network than JSBs partly due to the discriminatory regulation of the SBV, which restricts the ability of JSBs to open branches. However, since the beneficiaries of this project are urban MSEs located in major cities, JSBs do have an adequate network coverage to serve them.

A detailed analysis of MSEs lender characteristics is illustrated in the table below.

Table 7. SOCBs and JSBs as MSEs Lenders—A Comparison

	SOCBs	JSBs
Attitudes towards MSEs lending in urban areas	▪ Lack of motivation in doing business in MSEs segment due to its low attractiveness (except VBARD). ▪ VBARD focuses mostly on serving MSEs in rural areas.	Clear focus on MSEs segment in urban cities.
Recognition of the importance of MSEs business	Partly important (between 1 and 2) (except VBARD)	Important and very important (between 3 and 4)
Lending skills	Strong in analytical skills, but lack of communication skills and experiences in lending to MSEs.	Experiences in lending to MSEs. Relatively stronger communication skills.
Collateral management	Not flexible, especially in term of collateral evaluation and collateral selection.	Relative flexible in term of collateral evaluation. Acceptance of wider range of collateral.
Network	Sufficient	Adequate in major cities

As a result of insufficient motivations and lack of experiences in doing business with MSEs in urban areas, SOCBs will be excluded from further consideration in selecting potential banks with which to build cooperative linkages. The main focus of this study's evaluation will be on urban JSBs; however, to be more comprehensive, rural JSBs also deserve a further look in their "actual" lending business.

B. EVALUATION FRAMEWORK

This study seeks to identify commercial banks with which Business Development Services providers in general, and the SIYB program in Vietnam in particular, could establish strategic linkages to facilitate access to financial services for urban MSEs. To select an appropriate partner bank, the study will address the following three key questions:

[37] Renting fees are recognized as non-funded bank income.

(i) ***Where do banks want to go in the future?*** The study will look at the banks' mission, vision, and strategy to answer this questions. It is crucial to identify how important the MSEs sector is in the banks' strategic context.

(ii) ***Can banks achieve their future goal in servicing the MSE sector?*** The study will look at the banks' current positioning in the MSEs segment and their capabilities in implementing their strategy towards MSEs.

(iii) ***Are banks willing and committed to work with an external donor on this project?*** The study will look at the banks' commitment and willingness to cooperate with donors aiming to expand lending to the MSEs segment.

The basic elements of the study's evaluation framework are included in the table below.

Table 8. Basic Elements of Evaluation Methodology

Framework	Minimum Requirement
License	▪ Valid license with full range of banking activities.
Duration of Business Activities	▪ At least five years in operation.
Receptiveness to External/Donor Intervention	▪ Commitment and willingness to cooperate with donors. ▪ Receptiveness to external assistance.
Audit and Compliance	▪ Must be audited by a reputable audit company. ▪ Must be in compliance with the SBV's regulation. ▪ Effective internal control, monitoring and audit system shall be in place.
Management and Corporate Governance	▪ No conflict of interest between owners, management, and board of supervisory. ▪ Willingness of management to implement necessary institutional and structural changes.
Vision and Mission	▪ Have a clear vision and mission statement that is well communicated amongst management and staff. ▪ Focus on urban areas and lending to non-state sector.
Strategic Market Positioning	▪ MSEs lending shall be one of its core business unit. ▪ A solid strategic positioning in this MSEs segment. ▪ A sound business plan toward this segment
Risk Management	▪ Appropriate risk procedures, structures, and policies are in place for effective control of all operational and financial risks.
Financial Standing	▪ Sound financial standing in regards to profitability, liquidity, capital adequacy, asset quality and balance sheet structure.
Operational Structure	▪ Demonstrated ability to develop and implement its business plan. ▪ Management is able to mobilize human resource, technology and other resources to achieve business goals.

C. EVALUATION OF BANK'S VISION, MISSION AND STRATEGY

1. Vision and mission towards lending to non-state sector

2. Strategy towards lending to urban MSEs

3. Strategy towards commercial lending

D. EVALUATION OF BANK'S CAPACITY TO IMPLEMENT STRATEGY

1. Strategic market positioning towards the non-state domestic sector

2. Financial standing

2.1. Current Peer Analysis

Capital adequacy
Liquidity
Earnings Quality
Asset Quality

2.2. Outlook

3. Operational standing

3.1. Management Ability

3.2. Cost Management

3.3. Branch Network

3.4. Risk Management

3.5. Audit and Supervision

3.6. Quality Management

E. EVALUATION OF BANK'S COMMITMENTS TOWARDS EXTERNAL ASSISTANCE

Note:

These sections contain confidential information on banks performance and are therefore not included in this publication.

VII. RECOMMENDATIONS

A. CANDIDATE BANKS

Note:

This section contains confidential information on banks performance and is therefore not included in this publication.

B. A TWO-TIER TECHNICAL SUPPORT PACKAGE

Donor interventions to date have usually centered around a line of credit or guarantee fund plus a small technical assistance package for the participating banks. The pairing of these two components is important and should continue to be implemented in future donor-funded projects. However, the method by which each component is administered could be re-tooled to increase the effectiveness of donor interventions.

The findings from this study showed that JSBs consider internal organizational constraints to be the barriers that could be most easily overcome in MSE lending. These include the development of MSE-responsive products, implementation of appropriate structures and systems, and training of professional staff on the particularities of MSE lending. These interventions should aim at maximizing staff productivity, minimizing transactional costs, mitigating credit and institutional risk, while still maintaining a bank's profitability.

Donor interventions in MSE lending should be consistent with the overall banking sector reform agenda at the national level. For this reason, a two-tier approach containing a comprehensive training program to several institutions that will contribute to the strengthening of the overall sector, combined with a tailored and intensive technical assistance program and a line of credit to one or two institutions, is recommended in this study.

Level 1: Sector-Level Capacity Building to Ensure Wide Access to MSE-Focused Training by Interested Banks

For this level, the donor would be able to work with a broad number of banks who have shown genuine interest in MSE lending, thereby getting more "bang for the bucks." Staff training is one of the key elements in building a strong and healthy bank. Participation in training also offers staff the opportunity to network with their peers and helps to solidify the professional association among banks.

Characteristics of intervention:

- Focused and tailored training for credit managers and credit officers working with MSEs. Course content should include not just the 4Cs of credit (Character, Capabilities, Capital, Cash Flow) but also give concrete cases/examples in how to adapt credit analysis process to this segment, how to simplify yet still be thorough. Also important is the internal controls aspect since credit procedures for MSEs tend to be more decentralized.
- Training should be conducted by an international trainer that has experience working with this segment in other countries as well experience working in a commercial bank, preferably someone who has experience assisting banks to go downscale.
- A needs assessment should be conducted with participating banks prior to training to ensure relevancy of curriculum. A formal follow-up and evaluation process should also

be implemented to ensure the applicability of the course to the actual practice in the banks.

Level 2: MSE Line Of Credit and Intensive Technical Assistance to Two Partner Institutions

A line of credit would provide incentives for banks who may not be sufficiently capitalized to expand their lending to the MSE market. The line of credit should be paired with intensive technical assistance to ensure the effective utilization of funds and sustainability of the intervention. This study recommends working with a maximum of two JSBs to deepen the level of technical assistance provided.

Characteristics of intervention:

- The line of credit should be disbursed based on strict performance criteria related to targeted clients and portfolio quality. Each candidate should be required to submit a detailed business plan outlining their strategy for MSE lending, the operational and financial implications of that strategy, and projected budget and financial results.
- A monthly and quarterly report will be required to keep track of operational and financial performance. Reporting requirements should not impose an extra burden and should complement and/or be consistent with the types of data collected and used by the bank. Technical assistance should be provided if the core banking system is unable to generate required reports.
- The selected institution(s) should meet the criteria in Table 8 but may not have benefited from previous donor assistance. This ensures a more level playing field since donors have the tendency to "cherry-pick" and overlook promising smaller banks.
- Before a technical assistance program can be designed, a comprehensive diagnostic should be conducted. This will enable the technical assistance provider to assess the real needs and design an appropriate support program for the candidate banks.
- These partner institutions would participate in the Level 1 training program but in addition, would receive additional hands-on TA on specific operational aspects.
- Past donor technical assistance has focused on general training and credit manual. These are useful tools but it is uncertain how the institutions have really applied these skills, if at all. In this case, technical assistance should focus on implementation of systems and procedures that are appropriate to this segment, and should have a goal to reinforce the infrastructure of the bank. Interventions should cover aspects such as MSE product development, risk management procedures, client assessment and monitoring, staff training and incentives, etc.
- A field visit should be conducted to study the structure and systems of a commercial bank who has gone downscale to serve small and micro enterprises in the region. Indonesia or the Philippines would be potential candidates. BRI has an international visitors program that provides participants with a close-up and behind the scene look at the Unit Desa's operations.

C. OTHER AREAS OF SUPPORT

In addition to the institutional aspects, there are other non-financial aspects in which donor organizations could effectively intervene. First of all, donors should continue to strengthen market-support institutions such as a viable credit bureau to fill the information gap. In addition, the data collection capacity of the General Statistics Office (GSO) and research institutions should be reinforced to improve statistical reporting on the MSE segment. Secondly, continued support should be given to promote business development services that focus on providing useful, timely, and reasonably-priced consultancy and business management services to MSEs.

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LIST OF ANNEXES

ANNEX A. COMMERCIAL BANK SURVEY

I. INSTITUTIONAL INFORMATION

Legal name

Legal status

Registration/Incorporation date

Governing law or act

Regulatory agency

II. MARKET AND PRODUCTS

1. ***Vision and Mission***: Please describe the bank's vision and mission.

____

____

____

2. ***Strategic Objectives***. What does the bank want to achieve in terms of:

Customers: ____

Products: ____

Geographic network coverage: ______________________________

Market positioning: __________________________________

3. ***Market Segmentation:*** Please classify the importance of the following segments to the bank's current and future growth by scoring from 1 to 4. (1 is not important; 2 is partly important; 3 is important; and 4 is very important).

	Now	In 5 years
Policy lending for strategic investment projects	____	____
State-owned enterprises commercial lending	____	____
Private sector large and medium-sized companies	____	____
Private sector small-sized companies	____	____
Affluent urban retail customers	____	____
Households enterprises- micro enterprises	____	____
Rural retail customers (primarily farmers)	____	____
Urban and rural poor retail customers	____	____
Other segment (please specify)	____	____

4. ***Product and Services:*** Please estimate the proportional contribution of the following products and services to the bank's current and future revenue (net operating income before tax and provision).

	Now (%)	In 5 years (%)
Traditional Commercial Lending	______	______
Leasing, Forfeiting, Trade Financing	______	______
Saving and Deposit	______	______
Account and Settlement Transactions (incl. Cards Business)	______	______
Foreign Exchange Services	______	______
International Trade Services, Guarantees	______	______
Others (please specify)	______	______

5. ***Geographic Coverage:*** Please estimate the proportional lending exposure of the following segments to the bank's current and future lending exposure

	Now (%)	In 5 years (%)
Urban Cities	______	______
Rural Areas	______	______
Industrial Zones	______	______

6. ***Portfolio Structure:*** Please estimate the proportional lending exposure of the following segments to the bank's current and future lending exposure.

	Now (%)	In 5 years (%)
Private Sector	______	______
State-owned Sector	______	______
Foreign Invested Sectors	______	______
Semi-formal Households Sector	______	______

7. ***Client Growth:*** Please complete the table below on the number of clients served by your institution in the past three years.

	Dec-01	**Dec-02**	**Jun-03**
Total Clients			
Total New Clients			
Active Borrowers			
Active Depositors			
Branch Offices			

8. ***Competitive Positioning***: How would you rate the level of competition in your market?

Not competitive ❑ Partly competitive ❑ Highly competitive ❑ Not sure ❑

9. ***Competitive Advantages***: What do you consider to be your institution's competitive advantage?

____

____

____

III. LENDING ACTIVITIES

10. ***Generic Information***: Please complete the following table (units in VND million).

Loans	Dec-01	Dec-02	Jun-03
Total loans disbursement			
Total loans outstanding			
Total number of clients			
Average size of loans disbursed			

11. ***Products-Client Matrix***: Please complete the table below (units in VND million).

Description	Terms & conditions	Targeted clientele
Non- Collateralized Commercial Loan	Minimum Loan Size: Maximum Loan Size: Average Loan Size Average Lending Rate:	
Collateralized Commercial Loan	Minimum Loan Size: Maximum Loan Size: Average Loan Size Average Lending Rate: Collateral Covering Ratio:	
Consumers Loans	Minimum Loan Size: Maximum Loan Size: Average Loan Size Average Lending Rate: Collateral Covering Ratio:	
Leasing	Minimum Loan Size: Maximum Loan Size: Average Loan Size Average Lending Rate: Collateral Covering Ratio:	

IV. MICRO AND SMALL ENTERPRISE LENDING

12. Does your institution consider the private sector as an interesting market?

Yes ❑ No ❑

13. Within the private sector, does your institution consider the micro and small enterprises sector as a potential market (see definition of MSE below)[38]? Yes ❑ No ❑

[38] Definition of Micro and Small Enterprises (MSEs)

14. Has your institution tried lending to MSEs? Yes ❑ No ❑

15. If yes, please complete the following table summarizing the type of credit product offered. If no, please go to question #19.

Description	Average Lending Period	Average Loan Size	Average Lending Rate	Collection Rate	Collateral Covering Ratio	Was this product successful?
Fixed Assets Loan – Long Term						Yes ❑ No ❑
Working Capital Loan – Short Term						Yes ❑ No ❑
Term/Project Lending						Yes ❑ No ❑
Consumer Lending for MSE Owners						Yes ❑ No ❑
Pawn Loans						Yes ❑ No ❑
Other (e.g. leasing, insurance, etc.): ______________						Yes ❑ No ❑

16. How many MSEs clients does your institution have currently? ____________

17. What is the total amount of MSE loans has been disbursed in 2002? VND____________million

18. What is the total MSE loans outstanding in 2002? VND____________________ million

19. What are the main challenges / barriers in lending to MSEs? Please rate the significance level of each barrier by scoring from 1 to 8. (1 is least important; 8 is most important).

_______ Legal enforcement of loan contracts due to informal status of MSEs

______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

______ Insufficient information about MSEs (credit history, business plan, etc.)

______ Insufficient collateral

______ Bank's lack of capacity and resources to manage a high volume loan portfolio

______ Bank's financial products are not appropriate to MSEs' needs

______ Transaction costs are high relative to size of loan

______ Other (please state): ____

Micro Enterprises: Employed less than 10 workers. Annual revenue of between VND 4 to 40 million.
Small Enterprises: Employed between 10-49 workers. Annual revenue of between VND 40 to 200 million.

20. In your opinion, which barriers / challenges could be overcome easiest? (1 is least difficult; 8 is most difficult).

______ Legal enforcement of loan contracts due to informal status of MSEs

______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

______ Insufficient information about MSEs (credit history, business plan, etc.)

______ Insufficient collateral

______ Bank's lack of capacity and resources to manage a high volume loan portfolio

______ Bank's financial products are not appropriate to MSEs' needs

______ Transaction costs are high relative to size of loan

______ Other (please state): ________________________________

21. Would your institution bank be interested in lending to MSEs within the next 3 years?

Yes ☐ No ☐

We would appreciate very much if we can have a follow-up interview, ideally as an informal meeting with your Director and Head of Credit Department. In case a meeting with the Director and Head of Credit Department could not be arranged, please state the name and contact information for the appropriate personnel.

Name of contact person No.1: ______________________

Position/title: ______________________

Telephone number: ______________________

Name of contact person No.2: ______________________

Position/title: ______________________

Telephone number: ______________________

THANK YOU FOR YOUR PARTICIPATION IN THIS SURVEY!

ANNEX B. DONOR INSTITUTIONS SURVEY

I. INSTITUTIONAL INFORMATION

Institution Name	
Year started in Vietnam	
Type of assistance provided (ODA, grant, concessionary loan, technical assistance, etc.)	
Areas/sectors of assistance (private sector development, financial sector development, health, education, etc.)	

II. DEVELOPMENT OBJECTIVES

1. Please summarize your institution's objectives for the development of Vietnam's private sector.

____

____

____

____

2. How would you rate the level of private sector development in Viet Nam?

Inadequate ❑ Partly adequate ❑ Adequate ❑ Very adequate ❑

III. MICRO AND SMALL ENTERPRISES (MSEs)

3. Within the private sector, does your institution consider the micro and small enterprises sector as an important area of assistance (see definition of MSE below)[39]?

Yes ❑ No ❑

[39] Definition of Micro and Small Enterprises (MSEs)

Type	*Number of Workers*	*Legal status*	*Monthly revenue/sales*	*Loan size*	*Sectors*
Micro	1-9	Informal, semi-formal/ household	VND 4-40 million	Minimum VND 5 million, maximum VND 100 million	Services, manufacturing, small commerce/retail, agricultural production
Small	10-49	Household, formally registered	VND 40-200 million	Minimum VND 100 million, maximum VND 500 million	Services, manufacturing, small commerce/retail, agricultural production

4. Do you consider a lack of access to financing a significant constraint for MSEs?

   Yes ❑ No ❑

5. Has your institution supported projects that aim at facilitating financial services for MSEs? If yes, please go to question #6. If no, please go to question #10.

   Yes ❑ No ❑

6. Were/are these projects working with urban or rural MSEs?

   Urban ❑ Rural ❑ Both ❑

7. Has your institution supported projects that encourage formal financial institutions/commercial banks to serve MSEs in *urban areas*?

   Yes ❑ No ❑

8. If yes, please complete the table below summarizing the nature and results of the assistance. If no, please go to question #9.

Bank name & Location	**Type & amount of assistance**	**Duration of assistance**	**Number of MSEs served**	**Total amount disbursed**	**Average loan size**	**Experience successful?**
						Yes ❑ No ❑
						Yes ❑ No ❑
						Yes ❑ No ❑
						Yes ❑ No ❑

9. How would you rate the level of access to formal financing by *urban-based* MSEs?

   Inadequate ❑ Partly adequate ❑ Adequate ❑ Very adequate ❑

10. In your opinion, what are the main challenges/barriers in MSEs' access to formal financial services? *Please rank the significance of each barrier on a scale of 1 to 8, 1 being least significant and 8 being most significant.*

______ Insufficient collateral

______ Insufficient information about MSEs (credit history, business plan, etc.)

______ Legal enforcement of loan contracts due to informal status of MSEs

______ Transaction costs are high relative to size of loan

______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

______ Bank's lack of capacity and resources to manage a high volume loan portfolio

______ Bank's financial products are not appropriate to MSEs' needs

______Other (please state): ________________________________

11. In your opinion, which of these barriers/challenges will be the easiest to overcome? *Please rank each barrier on a scale of 1 to 8, 1 being least difficult and 8 being most difficult.*

______ Insufficient collateral

______ Insufficient information about MSEs (credit history, business plan, etc.)

______ Legal enforcement of loan contracts due to informal status of MSEs

______ Transaction costs are high relative to size of loan

______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

______ Bank's lack of capacity and resources to manage a high volume loan portfolio

______ Bank's financial products are not appropriate to MSEs' needs

______ Other (please state): ______________________________

12. Do you feel that donors have a role to play in facilitating MSE access to formal finance?

Yes ❑ No ❑

13. What will be your institution's priorities for private sector development assistance to Vietnam in the next five years?

____

____

____

____

14. Can we contact your institution for a follow-up interview regarding this topic? If yes, please state the name and contact information for the appropriate personnel.

Yes ❑ No ❑

Name of contact person: ______________________

Position/title: ______________________

Telephone number: ______________________

15. Are there other institutions we should contact regarding this topic? If yes, please write below.

Institution	Contact name	Position/Title	Telephone number

THANK YOU FOR YOUR PARTICIPATION IN THIS SURVEY!

ANNEX C. STATE BANK OF VIETNAM SURVEY

I. STRATEGIC OBJECTIVES

1 Please summarize your institution's objectives for the development of Vietnam's banking sector.

____

____

____

II. FINANCIAL SERVICES FOR THE PRIVATE SECTOR

2 How would you rate the level of private sector development in Viet Nam?

Inadequate ❑ Partly adequate ❑ Adequate ❑ Very adequate ❑

3 How would you rate the level of competition in the financial services market for the private sector?

Not competitive ❑ Partly competitive ❑ Highly competitive ❑ Not sure ❑

4 How would you rate the level of the private sector's access to formal financial services?

Inadequate ❑ Partly adequate ❑ Adequate ❑ Very adequate ❑

III. MICRO AND SMALL ENTERPRISE (MSE) LENDING

5 Within the private sector, does your institution consider the micro and small enterprises sector as an important area of support (see definition of MSE below)[40]?

Yes ❑ No ❑

6 Do you consider a lack of access to financing a significant constraint for MSEs?

Yes ❑ No ❑

[40] Definition of Micro and Small Enterprises (MSEs)

Type	*Number of Workers*	*Legal status*	*Monthly revenue/sales*	*Loan size*	*Sectors*
Micro	1-9	Informal, semi-formal/ household	VND4-40 million	Minimum VND 5 million, maximum VND 100 million	Services, manufacturing, small commerce/retail, agricultural production
Small	10-49	Household, formally registered	VND 40-200 million	Minimum VND 100 million, maximum VND 500 million	Services, manufacturing, small commerce/retail, agricultural production

7 Has your institution implemented policies and/or activities that aimed at facilitating financial services for MSEs?

Yes ❑ No ❑

8 Were/are these projects working with urban or rural MSEs?

Urban ❑ Rural ❑ Both ❑

9 Has your institution implemented policies and/or activities that encourage formal financial institutions/commercial banks to serve MSEs in *urban areas*?

Yes ❑ No ❑

10 If yes, please complete the table below summarizing the nature and results of the activities *(if more space is needed, please attach additional sheets to questionnaire)*. If no, please go to question #13.

Bank name & location	**Description of products & services**	**Number of MSEs served**	**Total amount disbursed**	**Average loan size**	**Experience successful?**
					Yes ❑ No ❑
					Yes ❑ No ❑

11 How would you rate the level of access to formal financing by *urban-based* MSEs?

Inadequate ❑ Partly adequate ❑ Adequate ❑ Very adequate ❑

12 In your opinion, what are the main challenges/barriers in MSEs' access to formal financial services? *Please rank the significance of each barrier on a scale of 1 to 8, 1 being least important and 8 being most important.*

_______ Legal enforcement of loan contracts due to informal status of MSEs

_______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

_______ Insufficient information about MSEs (credit history, business plan, etc.)

_______ Insufficient collateral

_______ Bank's lack of capacity and resources to manage a high volume loan portfolio

_______ Bank's financial products are not appropriate to MSEs' needs

_______ Transaction costs are high relative to size of loan

_______ Other (please state): ____

13 In your opinion, which of these barriers/challenges will be the easiest to overcome? *Please rank each barrier on a scale of 1 to 8, 1 being least difficult and 8 being most difficult.*

_______ Legal enforcement of loan contracts due to informal status of MSEs

_______ Perception that lending to SOEs and larger enterprises are more secure and more profitable

_______ Insufficient information about MSEs (credit history, business plan, etc.)

_______ Insufficient collateral

_______ Bank's lack of capacity and resources to manage a high volume loan portfolio

_______ Bank's financial products are not appropriate to MSEs' needs

_______ Transaction costs are high relative to size of loan

_______ Other (please state): ________________________________

14 Do you feel that the SBV have a role to play in facilitating MSE access to formal finance?

Yes ❑ No ❑

15 What will be your institution's priorities for the banking sector during the next five years?

____

____

____

____

16 Can we contact your institution for a follow-up interview regarding this topic? If yes, please state the name and contact information for the appropriate personnel.

Yes ❑ No ❑

Name of contact person: ________________________________

Position/title: ________________________________

Telephone number: ________________________________

17 Are there other institutions we should contact regarding this topic? If yes, please write below.

Institution	Contact name	Position/Title	Telephone number

THANK YOU FOR YOUR PARTICIPATION IN THIS SURVEY!

ANNEX D. COMMERCIAL BANK PRODUCT MATRIX

Regular Banking Products	Minimum Size (VND million/USD)	Maximum Size (VND million/USD)	Average Size (VND million/USD)	Average Lending Rate (per month)	Average Collateral Covering Ratio
1. Non-collaterized commercial loan	VND 32.5 USD 2,200	VND 16,310 USD 1.1 million	VND 200 USD 13,000	0.88%	N/a
2. Collaterized commercial loan	VND 64 USD 4,300	VND 15,615 USD 1 million	VND 1,174 USD 78,000	0.91%	88%
3. Consumer loans	VND 11.1 USD 740	VND 1,747 USD 116,000	VND 147 USD 9,800	0.98%	71%
4. Leasing[a/]	VND 70 USD 4,700	VND 15,350 USD 1 million	VND 10,200 USD 680,000	0.88%	25%
MSE Products	**Average Lending Period (month)**	**Average Size (VND million/USD)**	**Average Lending Rate (per month)**	**Average Collection Rate**	**Average Collateral Covering Ratio**
1. Fixed assets loan - long term	42	VND 208 USD 13,900	1.00%	98%	89%
2. Working capital loan - short term	10	VND 240 USD 16,000	0.91%	99%	101%
3. Term/project lending[b/]	14	VND 474 USD 31,600	0.92%	99%	103%
4. Consumer lending for MSE owners[c/]	20	VND 136 USD 9,100	0.95%	99%	99%
5. Pawn loans[d/]	34	VND 2,225 USD 148,000	0.95%	99%	100%

Notes:

A/ Only two of the responding banks offered this product.

B/ One responding bank offers a loan size that is three times greater than the others hence the total average is a bit skewed. If that one bank is not taken into consideration, the average loan size for this product would be VND 294 million (USD 19,600).

C/ Four out of the seven responding banks who offer this product report an average loan size of under VND 70 million (USD 4,700).

D/ One responding bank offers a loan size that is much greater than the others hence the total average is a bit skewed. If that one bank is not taken into consideration, the average loan size for this product would be VND 275 million (USD 18,000).