Fuzzy information policy of the Vietnam Bank for the Poor in lending to and targeting of the poor in Northern Vietnam

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1 Introduction[1]

A broad access to appropriate and sustainable financial services has been pointed out repeatedly to be important for poverty reduction. It contributes to higher income and better food security (ADB 2000; Buchenrieder and Theesfeld 2000; Schrieder 1996; Zeller *et al*. 1997). Many poor households are faced with transitory food insecurity, even though their incomes seem to provide a sufficient livelihood base over several years. Thus, there is a potential demand for savings, credit, and insurance services to more effectively stabilize consumption and to raise the ability to escape chronic poverty (Kanbur and Squire 2001; Zeller 1999).

Hunger eradication and poverty alleviation, particular in the northern uplands, is of enormous concern to the Vietnamese government (Ahmed and Goletti 1997; VBP 1999). The Ministry of Agriculture and Rural Development (MARD) proposes financial services as a powerful tool for poverty reduction (Sida-MARD 1998). From the early 1990s onwards, the Vietnamese government has begun to establish and promote formal financial intermediaries (FFIs) such as the Vietnam Bank for Agriculture and Rural Development (VBARD), the Vietnam Bank for the Poor (VBP) and the People's Credit Funds (PCFs) to provide the rural poor with loans.[2] In addition, the State Treasury has implemented special sector credit programs, e.g. the 120-program for promoting employment which is headed by the Ministry of Labor, Invalids and Social Affairs (MOLISA). This loan policy is based on the assumption that (1) the rural population is too poor to repay credits at market interest rates and that (2) capital is the scarce resource for increasing production and thus raising food security.

The Vietnam Living Standard Survey 1997-98 shows that FFIs have been very successful in increasing their level of outreach, i.e. the state-owned VBARD and the VBP have reached almost 4.5 million and 2.5 million rural households with credit, respectively (Bac 2001; Hanh 2001). These are more than 58% of all rural households in Vietnam. The majority of the loans to the rural poor is given by the VBP through a group lending scheme whereby the highest

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[2] In 1988, the VBARD emerged from the mono-bank system. At that time, it was called „Agricultural Development Bank of Vietnam". Its name was changed in 1990 into Vietnam Bank for Agriculture (VBA) (Seibel 1992). The VBP was only established in 1995 as its lending outlet for the poor of the VBA. The PCFs emerged from the cooperative banking system that was originally part of Vietnam's mono-banking system. While most of the original cooperative banks went bankrupt after the introduction of a two-tier banking system, 80 survived. 78 out of them are today part of the more than 800 PCFs which are legally based on the decree No. 390/Tg of 1993 (Seibel 1997).

lending activity of the bank is found in the northern highlands and the lowest is observed in the southeast and central highlands (VBP 1999).

The state-owned VBARD and VBP collaborate with the local governments at commune level, particularly the People's Committees (PCs) as well as mass organizations such as the Women's Union and the Farmers' Union. This operational arrangement has proven quite successful in expanding the availability of credit to subsistence farm households (VBARD and DANIDA 1999). Nevertheless, there exist rural financial market failures because credit is made available not to those rural households with the most profitable investments but to those which are best informed.

1.1 Problem statement

The VBP focuses on the poorer segment of the rural households. It faces particularly high transaction costs (TCs) because of the remoteness of the majority of their borrowers, the small credit denominations, and the extensive administrative procedure in the credit allocation process. Some of the operational steps within the screening and monitoring process are managed free of charge (e.g. by village leaders) but most by paid professionals (e.g. by credit officers). Currently, the average operational costs of the VBP, expressed as interest rate spread, is 0.45% per month (Hanh 2001). The monthly interest rates charged by the VBP vary between 0.6% and 0.7%. This means that between 64% and 75% of the interest revenues are used to cover operational costs.

The allocation process of VBP loans for the rural poor is in many aspects top-down. District, commune and village officials are heavily involved in this process. Apart from that, the commune and village authorities are involved in dissemination of credit information, screening, and monitoring of rural households and especially in exerting pressure on households with overdue loans. This ought to reduce information asymmetry (VBARD and DANIDA 1999). But this approach has created at the commune and village level typical principle-agent problems.

Empirical evidence suggest that (1) the heads of the communes do not necessarily sufficiently inform all villages in their communes about the credit availability and that (2) village officials do not always make certain that all households in their village get the news. It appears that these two administrative steps contribute to resource misallocation in the sense that potential borrowers with profitable investments are excluded due to a lack of information. Information deficits therefore undermine the access of the poor to credit (Kanbur and Squire 2001). Furthermore interviews with key persons have shown that (3) local authorities are also responsible for the poverty assessment of households and might assess HHs of relatives, friends, or neighbors rather too poor to give them easier access to loans of the VBP.

Based on these problems, one could claim that access to more timely and complete information could contribute not only to a more efficient allocation of funds but also to an allocation that benefits more effectively the true target group which are the rural poor. Therefore information availability in the credit allocation process is crucial for the empowerment of the rural poor and subsequently for raising their welfare.

1.2 Objectives and methodology

Beside the effect of information deficiencies, the effect of information asymmetry on the national poverty alleviation policy is evaluated. Key objectives of this contribution are (1) to identify crucial gatekeepers of important credit information and (2) to describe the formalized and non-formalized information channels and to which extent they reach the target group.

Methodologically, this contribution combines secondary data from the FFIs and empirical evidence from the commune and household levels. The qualitative and quantitative data were collected between March and October 2001 in the Ba Be district, Bac Kan province of Northern Vietnam. The analysis of information flows of FFIs at the district and provincial level produced insights on policy objectives and formalized procedures of credit fund allocation. The survey comprised 118 households in four villages and three communes of Ba Be district. By way of a so-called 'social mapping'[3], the relationships of members in credit groups was made transparent. Semi-structured interviews with key persons such as mass organization officials, credit officers, credit group leaders and members at the village and commune level provided data on the credit allocation.

1.3 Structure of paper

Section 2 provides the theoretical background to the evaluation of information-economic issues. The target group criteria and the outreach of the VBP are discussed in Section 3. The decision making process of credit allocation the Vietnamese poor by the VBP is described in Section 4. Finally, policy conclusion and policy recommendations are summarized in Section 5.

2 NIE and the analysis of information flows in Vietnam's rural credit allocation[4]

The term 'New Institutional Economics' (NIE) delineates a branch of economic theory which focuses on institutions and organizations while maintaining the basic principles of neo-classical economics such as the utility maximization assumption, the marginal benefit principle, the efficiency assumption, the equilibrium thinking (Schmidt and Terberger, 1996), and the rational-choice model, or the *homo economicus* with bounded rationality (Richter, 1990). Nevertheless, the efficiency-direction of NIE modifies the protective belt of neo-classical economics by including positive TCs and the constraints of property rights (PRs) (Eggertsson, 1990).[5] The NIE defines an 'institution' as a commonly accepted set of formal rules and informal constraints that shape human interaction. Institutions also consist of the enforcement characteristics of the rules and constraints (North, 1989).

If a situation does have TCs or information problems, then it does matter how wealth and property rights (PRs) are distributed. Modern economic theory emphasizes that TCs depend on institutions, that institutions are endogenous, and that the distribution of wealth affects economic efficiency both directly and through its effect on institutions. Distribution of wealth, institutions, and efficiency are inseparable. Therefore, TCs caused by information asymmetry and risk are of particular importance in developing countries (Hoff and Stiglitz 2001).

2.1 Transaction cost

TCs decrease the efficiency of exchange relationships (Grindle, 2001). The regulatory frame work of institutions shall reduce TCs and raise the efficiency of exchange. Although a standard definition has yet to be agreed upon, Egertsson (1990: 14f) defines TCs as "the cost

[3] Villagers drew a map of their village including all households. Then the households of the CGL with their relatives, the credit group members, and all key persons with their relatives were marked.

[4] The following section draws on Buchenrieder (2002).

[5] Three directions within NIE can be delineated, all of which contribute to the understanding of institutional change: (1) the efficiency direction that concentrates on minimizing TCs, analyses path-dependent institutional chance etc., (2) the Public Choice direction, and (3) the distribution direction that analyses the impact of access to power and resources on institutional change (Schlüter, 2001).

that arise when individuals exchange ownership rights to economic assets and enforce their exclusive rights". TCs include all expenses and opportunity costs, fixed and variable, which arise in the exchange of PRs, except the price of the PR itself. The costliness of information is the key to the costs of transaction. Thus, reducing the cost of information means reducing TC. In New Development Economics (Stiglitz 1986), TCs are considered to be of substantial interest for development finance (Fiebig, Hannig, and Wisniwski 1999).

One way to classify transaction costs is: (i) prior to the transaction, ***information costs*** mostly related to searching for and screening potential trading partners and obtaining price information; (ii) during the transaction, ***negotiation costs*** including costs of arranging the transactions, physically transferring the product or service, and drawing up contracts; and (iii) after the transaction, ***enforcement costs*** related to monitoring the terms of the transaction and enforcing liability (Randolph and Ndung'u 2000).

As Hoff and Stiglitz (2001) pointed out, the structure and the volume of TCs depend on the institution respectively on the institutional environment. For instance, recent research in Thailand has shown, that the type of lender (institution) strongly influences the level of TCs incurred by borrowers (Erhardt 2000). In the case of lending, TCs of the borrower and lender include all explicit and implicit expenses that occur in the process of disbursing and obtaining a loan, respectively. Those costs are associated with, in case of the borrower, e.g. transportation, paperwork, lodging and meals, gifts and opportunity cost of time (Heidhues, Sossoh, Schrieder 1997) and in the case of the lender, e.g. wages, depreciation of equipment and loan arrears. The remoter the area, the more marginalized a group of people is, the higher are the TCs usually.

2.2 Principal-agent concept

The theory of agency relationships is a branch of the economics of TCs. Information is not always readily available or easily traded. Information may be communicated from one person to another, but it may be difficult to verify whether it is strictly true. This provides the basis for 'opportunism', meaning the incomplete or distorted disclosure of information in order to hide the true facts (Williamson, 1998). In agency relationships, uncertainty and asymmetric information are the consequence (Richter and Furubotn, 1996). Decision making in such circumstances is presented by the agency relationship in which two parties embark on a mutually beneficial hierarchical relationship, one being better informed than the other. The uninformed party is called the 'principal' while the other, who has all the information is the 'agent'. The identification of which party to a transaction is the principal and which is the agent depends on the circumstances. Each individual in a hierarchical structure, except at the ultimate level, is simultaneously a principal and a agent when rights are transferred down the organizational ladder (Eggerston, 1990).

In an agency relationship, the principal delegates PRs to an agent, who is bound by formal and informal contracts and conventions, respectively, to act in the principal's interest in return for benefits of some kind. Thus, agency problems are characterized by the fact that an agent's decision does not only influence his own but also the principal's utility (Jensen and Meckling, 1976). Due to the conflicting interests between principals and agents as well as the asymmetrical information, behavioral risks may emerge. Usually, the principal does not observe the agent's actions but rather the result of his actions. Agents may be evaluated by measuring their behavior and attributes in a costly process applying proxies such as university degree and number of hours worked. If the proxies are limited too much, asymmetric information is the result, and this may give rise to opportunistic behavior on the part of the agent or, in other words, agents are likely to make sub-optimal decisions from a principal's viewpoint unless they are effectively constrained. Market competition can, in various ways, reduce the agency costs to principals and raise the costs to agents of opportunistic behavior (Eggertsson, 1990).

Jensen and Meckling (1976) differentiate the categories of agency costs: (1) monitoring costs (costs which arise for the principal to achieve more transparency over the activities of the agent), (2) guarantee costs (costs which arise for the agent to show his reliability to the principal), and (3) residual costs (costs that result from a lower than agreed performance of the agent). As pointed out earlier the actions of an individual are not easily observable. For instance, a bank entrusts resources to a borrower but can not perfectly monitor his investments and initiative; a landlord entrusts land to a tenant but cannot easily monitor his effort and care. The task of the principal is to design an incentive scheme to try to align the agent's incentives with his own. The principal-agent literature focuses on the design of contracts to motivate the agent to act in the principal's interest. Contract provisions that can achieve this are collateral, bonds, and provisions that shift the risk of poor output onto the agent. The greater the agent's ability to post collateral, put up a bond, pay rent in advance, or absorb risk, the greater the agent's incentives to take appropriate actions (Hoff and Stiglitz 2001). The problems of delegation and commitment are thus central in a principal-agent framework (Grindle 2001).

In a typical development finance approach, credit officers (agents) possess vastly more detailed and accurate information about the local environment and the clients than does central management (principal). In the presence of such 'information asymmetries' and high monitoring costs, managers are well advised to align the objectives of the institution (which usually include a mix of outreach and profitability indicators) with those of the agents (credit officers, head of communes) who actually make the vast majority of operational decisions. But these contracts need to be handled with care, as badly designed contracts can have many unwanted side effects. In fact it is better not to set incentives at all instead of bad adjusted ones (Holtman 2001).

3 Outreach of VBP to the rural poor in Ba Be

First this section describes the poverty criteria and eligibility of rural households for VBP loans. Then we discuss the outreach of the VBP to the rural poor in the research area. While the term 'outreach' is used from the perspective of the financial intermediary and 'access' is used from the point of view of the potential client, they both refer to the same thing: who is getting the credit (Vaessen 2001). In the following sections we will describe which types of borrowers can access the loans of the VBP in the research area.

3.1 Target group definition and poverty criteria

The majority of poverty focused development finance programs incorporate client selection criteria which attempt to limit participation to poorer households. However, despite attempts to simplify and objectify these procedures, most programs fail to maintain a focus on the poor and have very little outreach to the extremely poor. Targeting failure occurs when non-target households are included and when target households are excluded. The latter is of great concern to those concerned with poverty alleviation. Exclusion of target households may result from simple failure to identify them but very often is the result of deliberate efforts by program officials close to the target group to bar poor households, which are perceived as credit risks (Hickson 2001). While this behavior reduces the TCs of the development finance program it reduces quality outreach. Another aspect that needs consideration in poverty lending is whether it is necessary to measure poverty or whether it is sufficient to rely on the self-selection mechanism of appropriately designed poverty oriented financial services. Such financial services are to be designed in such a way that the better-off would not care to access them (Seibel 1996). Relatively small loan volumes and group lending schemes go into this direction. While these characteristics apply to the VBP lending conditions to the poor, it explicitly monitors the poverty level of its borrowers and tries to exclude the better-off and the hungry households, clearly this contributes to the operation costs of VBP.

Under the VBP, poverty is determined in accordance with the MOLISA criterion as the inability to provide for basic nutritional needs. The mandate of lending was formerly characterized as the following: "First to the starving, then to the hungry …" (VBARD and DANIDA 1999: 2). Nowadays, the hungry households are generally excluded from the VBP. "Other national programs shall take care of them" (Bao 2001).[6] Obviously a principle change has taken place. Nevertheless, MOLISA has recently broadened the poverty criteria. The poverty line for rural people in the uplands is now less then 80,000 VND[7] per month and person (MPI 2001). This change implies that households, which were formerly considered as medium-income households are now assessed as poor. For the VBP this has created a difficult situation as the bank does not have sufficient funds to satisfy the credit entitlements of the expanded group of potential borrowers (Thu 2001).

The Poverty Reduction Board (PRB) is responsible for the wealth ranking of the households. It exists in each commune. The members are usually the head of the commune as the superior official (in most cases he is also the chairman of the board) and the heads of the respective mass organization at commune level.[8] The village heads are so called 'temporary consultant' members of the board. The wealth ranking of the households is carried out together with the village heads according to nationally defined poverty criteria (see Table 1 represents the wealth ranking in the survey communes to this paper). This ranking is done once per year. Many households try to be ranked as poor to improve their chance of accessing a VBP loan. The rather great number of people who are responsible for the ranking ought to reduce the danger of nepotism, a typical principal-agent problem.

For each household in the commune, the members of the PRB estimate roughly the income according to the given standards (see Table 1). The ranking is done by applying participatory instruments (Anh 1997). Other factors than income are playing a much greater role for determining the socio-economic standing of a households, such as area of paddy rice land, education, food security, off-farm activities (Geppert and Dufhues 2001).

The VBP has delegated the responsibility to the heads of the communes (and PRB) to verify that only households which are classified as poor according to the national poverty criteria benefit from the VBP credit line. For his duty in the screening process, the head of commune receives apparently an incentive which is based on the credit volume and the repayment rate

[6] It is assumed that hungry households are not capable to use a loan productively and to repay the principal and interest. Two very important aspects are not considered in this way of thinking: First, a consumption loan which is used for food can also be seen as an investment as it is invested into the most important production factor of the poor, namely labor. Second, with this approach all hungry households would have to be assessed as not creditworthy. While this is probably true for many hungry households, it is not for all.

[7] According to the decree no. 1143/2000/QD- LDTBXH of November 1, 2000 were adapted. Before the rural poverty line was 55,000 VND. One USD is equal to 15,709 VND (Sunday, October 14, 2001, http://www.oanda.com/convert/classic).

[8] The most important mass organizations in rural areas are the Farmers Union and Women's Union.

in the commune.[9] He is also highly involved in the reinforcement of the repayment overdue loans. This is of course an unpleasant additional duty, which the commune head rather tries to avoid. The information asymmetry between the principal (VBP) and agent (head of commune) combined with the adverse incentive causes opportunistic behavior on the agent's side.

Table 1 Income categories of households in VND/month and person

Commune	Dia Linh	Nghien Loan	Xuan La
Hungry HH	< 55,000	< 60,000	< 60,000
Poor HH	55,000 – 79,000	60,000 – 79,000	60,000 – 79,000
Medium HH	80,000 – 169,000	80,000 – 99,000	80,000 – 99,000
Better-off HH	170,000 – 219,000	100,000 – 119,000	100,000 – 119,000
Rich HH	≥ 220,000	≥ 120,000	≥ 120,000

Source: Administration book Dia Linh commune, 2000; Statistics book Nghien Loan commune 2001; Statistics book Xuan La commune 2001

Note: Although all communes should follow the nationally set poverty criteria, in praxis the commune heads may not have the most current information, thus borders overlap between communes. HH = household.

The classification of hungry and poor HHs is defined by MOLISA. The communes can vary the boarders only slightly depending on the local situation. The band for variation for the definition of the boarders for medium, better-off, and rich HHs is more flexible (Dung 2001).

Therefore, he has an interest to exclude those households, which he assumes to have a low repayment capacity. Clearly, this has a positive effect for the bank because the repayment rate rises and for the household as well, as it reduces the negative effects of indebtedness beyond its repayment capacity. At the same time, he will more likely select those households which may not be poor according to the national criteria and have a higher credit demand. As the head of commune has a very powerful position within the local administration, he also has the power to influence the poverty assessment of households. Hence, a better-off household might be assessed as poor due to his influence and thus, is eligible to receive a loan from the VBP instead of a more expensive one from the VBARD.[10] The national policy objective, namely that only truly poor households gain access to loans from the VBP is thus attenuated.

3.2 Outreach of formal credit market in the research communes

The outreach of the VBP differs greatly from commune to commune (see Table 2). In the Xuan La commune, 65% of the households received a credit. In the other two research communes, only about 20% of the households accessed a loan from the VBP. At first sight this is surprising because the Xuan La commune is the remotest of the three. But many of the

[9] According to the information obtained from Mr. Bao (2001), the head of commune receives 80.000 VND per month for his collaboration, if: (1) the lending volume exceeds 100 mio VND, (2) more than 50 HH receive a loan, (3) the repayment rate is over 80%, and (4) the volume of bad debts is less than 4% of total credit volume. If one of these conditions is not fulfilled, he receives only 50,000 VND, thus the incentive is 30,000 VND. The monthly salary of the head of commune is 360,000 VND. The general rule is that an incentive of less than 20% of total remuneration does not create significant stimulus to improve performance (Holtmann 2001)

[10]The giant part of the loans of VBARD/VBP is used for few purposes, e.g. raising buffaloes or pigs or buying land. The profitability of these investments (e.g. pig raising) varies only little between villages in one commune.

credit groups in the Xuan La commune are inter-village groups. The creation of inter-village groups has the advantage that farmers from villages which are not able to build their own group can take part in groups of other villages. This widens the outreach, however it may reduce social coherence among the members and thus induce moral hazard among group members.

Whether or not credit groups are created in a village depends heavily on the ability of enough persons who are capable and willing to be a credit group leader (CGL)[11]. In two of the four research villages, credit group creation failed because no suitable CGLs could be found. Obviously there is an unsatisfied demand for CGLs. The CGL must fulfill the following features:

- She/he must be mobile as the person has to travel to the district branch of the VBP and to the commune during the application procedure of the group members. In many groups the CGL also has to collect the interest payments and often she/he must carry the money to the district branch.
- She/he must have a minimum level of education as the CGL has to negotiate with local authorities and bank staff. She/he also has to support the other members in completing the forms and in planning the investment.
- She/he needs to have ‘good’ contacts to the local authority network to get all necessary credit information at the right time and to get the application approval from them.
- She/he needs a certain level of wealth because in case of delayed repayment of interest by members, the CGL normally advances the money.

The remoter the area, the more probable is the lack of persons with the requested abilities. This can lead to the creation of inter-village credit groups. Less remote villages, usually inhabited by the Tay[12] minority, which have a greater number of potentially suitable CGLs often also have a higher number of credit groups than remote villages. Friends or relatives from other villages may be allowed to participate in these credit groups. Although no empirical evidence was found, this arrangement leaves room for bribery and thus increases the TCs for the credit group members. Clearly, human capacity and wealth distribution play also a significant role in institutional development not only efficiency considerations (Schlüter 2001).

[11]Every credit group must have a CGL. The CGL is usually the one who builds the group. She/he gets a one-day training course carried out either by the head of the district VBP or by the credit officer. She/he has the obligation to support the group members in all credit matters. As compensation for this task she/he receives the difference between the interest rate charged to the credit group members (0.7%/month) and the interest rate to be paid to the VBP (0.6%/month).

[12] The Tay minority presents in this area the majority of population. Tay villages are usually less remote and located in valleys. They can usually speak Vietnamese and all important local authorities are part of this ethnic group.

Table 2 Wealth status and VBP loans of HH in research communes

	Dia Linh (N = 602*)		Nghien Loan (N = 848)		Xuan La (N = 426**)	
	N	%	N	%	N	%
HH with VBP credit	123	20	152	18	275	65
Hungry HH	54	9	111	13	75	18
Poor HH	73	12	300	35	118	28
Medium HH	184	31	397	47	112	26
Better-off HH	205	34	30	4	66	15
Rich HH	84	14	10	1	32	8

Source: Administration book Dia Linh commune, 2000; Statistics book Nghien Loan commune 2001; Statistics book Xuan La commune 2001; Credit book Dia Linh commune, 2001; Statistics book Nghien Loan commune 2001; Statistics book Xuan La commune 2001

Note: *two HH are not included in the wealth ranking; **23 HH are not included in the wealth ranking; therefore, the sum of the HH in percent does not equal 100%.
N = number of households in one commune; HH = household.

Table 3 shows which villages in three research communes have access to VBP loans. Is also illustrates the percentage of households per village with loans. One could assume that the villages with a high percentage of VBP loans are those villages with a high number of target group households, namely the poor. Primary data do not confirm this statement. For example, in the village Thom Meo, 33% of the households fall below the poverty line but 80% of all households received a VBP loan (gap: 47%). The gap is even wider, namely 61% since the hungry households are considered to be too poor to efficiently invest loans. Obviously, for the reasons discussed above, non-target group households have gained access to VBP loans. This is also confirmed by Table 2 (see above), as this table shows that in the Dia Linh and Xuan La communes a greater share of households possess VBP credits than just the share of poor households in the communes.

Table 3 Percentage of HH per village with VBP credits

Dia Linh (N = 9 villages)		Nghien Loan (N = 12 villages)		Xuan La (N = 10 villages)	
Name of village	%	Name of village	%	Name of village	%
Coc Pai (13 HH)	46	Phia Deng (111 HH)	86	Thom Meo (85 HH)	80
Ban Vang 1 (73 HH)	38	Ban Dinh (86 HH)	22	Khoui Khi (40 HH)	37
Na Duc 2 (86 HH)	36	Khuoi Tuon (29 HH)	21	Nam Nha	n/a
Pac Nghe 1 (76 HH)	34	Khuoi Thao (40 HH)	13	Khuoi Boc	n/a
Na Duc 1 (101 HH)	16	Khuoi Un (70 HH)	11	Co Luong	n/a
Ban Vang 2 (75 HH)	13	Pac Gia (144 HH)	7	Luong Muong	n/a
Pac Nghe 2 (50 HH)	12	Ban Na (129 HH)	6		

Source : Own data, Rural Finance Survey (2001)

Note: In Dia Linh commune two villages (22%), in Nghien Loan commune five villages (42%), and in Xuan La commune four villages (40%) have no credit group.

n/a = not available, HH = household; N = number of villages in the commune.

In the Ngien Loan commune ,also inter-village credit groups are found. Therefore, the percentage share does not necessarily present the actual number of HHs with a VBP credit in one village.

4 Decision making process of credit allocation for the poor in the case of VBP

Section 4 describes very briefly the credit policy of VBP (Section 4.1) before discussing the credit allocation process of the VBP to the communes (Section 4.2). Thereafter, it is explained how farmers gain access to the loans. The section concludes with a description of the information channels between the target group and VBP.

4.1 Credit policy

The VBP was established in 1995 as the poor people's lending outlet of the VBARD. The VBARD concentrates on the better-off market segment and provides individual loans and also offers savings services.[13] As the VBP, it is a state-owned bank, specialized in lending to poor households (see Table 1 above), savings mobilization plays a very minor role in the service array of the VBP.[14] The purpose of the VBP is not to maximize profit but to reduce poverty (Hanh 1999, VBP 1999). The VBP is allowed to use the operational facilities and staff of the

[13] Recent credit policy developments, however, show that the credit products of the VBARD and VBP are becoming more and more similar and thus their market segments. For instance, the VBARD now tries to offer a credit product that does not require a collateral for loans below ten million VND (VBARD 2001). At the same time, the VBP has broadened its credit term to five years and raised the maximum amount to five million VND (VBP 2001). It is not clear to potential customers, whether this credit is a VBP product or whether it is a VBARD product, offered by the VBP (VBARD 2001).

[14] It is a national consensus which is adopted by the local staff of the VBARD/VBP that poor households are not capabable to save (Cat 2001, Chan 2001). This is although many NGOs in Vietnam have proven otherwise.

VBARD and of mass organizations at commune and village level in extending its services to the target group. From the monthly interest rate charged to the clients, 0.1% is paid to the local mass organizations and 0.25% to the VBARD for its services (Nguyen 1998). Currently, the average operational costs of the VBP, expressed as interest rate spread, is 0.45% per month (Hanh 2001). The monthly interest rates charged by the VBP vary between 0.6% and 0.7%. As mentioned earlier, this means that between 64% and 75% of the interest revenues are used to cover operational costs. This implies that between 25% and 36% of the interest revenues remain to cover refinancing costs. The repayment performance of 98% is very good (Hanh 2001). But this is only a poor measurement of good performance as re-scheduling of loans in VBP is extremely high; reported as high as 70% in some provinces (VBARD and DANIDA 1999).

The poverty focus of the VBP and the high operational costs do not mean that the bank subsequently operates at a loss. But due to the highly subsidized interest rates many international institutions consider VBP not to be financially sustainable.[15] Vietnamese policy makers have realized this issue and declare the subsidized interest rate policy as a temporary strategy. In the long term, market rates should be implemented (1999 VBP). However, this objective has not yet been achieved (see Table 4).[16]

Table 4 Nominal interest rates per month of the VBP in Ba Be district

Year	1997	1998	1999	2000	2001
Interest rate	1.2	1	0.8	0.6	0.6/0.5

Source: Annual reports of the VBP 1997-2001 at Ba Be District

The VBP uses joint-liability group lending schemes to reach out to the poor (VBP 2001). But in the daily practice, the group members are not kept liable for each other. If one group member defaults, the only consequence for the other members is that this particular group does not receive a credit anymore. But individual members, who repaid on time, can join a new group.

In March 1999, the maximum loan size per group member had been set to three million VND (around 190 USD) and a maximum term of three years. In 2001, the loan size has been raised to five million VND and the term to five years. The interest rate payments are collected every month, or every three or six months and the principal is usually paid at the end of the term.

4.2 Credit allocation process

The VBP relies for its credit allocation estimation on information from several public organizations and subordinated branches at the district and provincial level. First, the PRB compiles a list of all poor households in their commune. This list is passed on to the MOLISA representative in the district. Second, the district-level VBP estimates the necessary credit

15 The VBP now is now recognized as loss making (VBARD and DANIDA 1999). If the government has not sufficient funds to finance the soft loans of the VBP, the Vietnam State Bank must refinance the VBP without interest on a long term basis and without a pre-fixed repayment date (Nghia 2001).

16 The law on credit institutions approved by the National Assembly in 1997 stipulates that the state shall establish banks which operate on a non-profit basis (Article 10). This implies that the state will continue to provide cheap credit to rural areas and the poor (Minot and Golletti 2000).

amount for the district and delivers this figure to the provincial level.[17] There, the same procedure is repeated. Based on the figures of the provincial branches, the VBP headquarter in Hanoi determines the nationwide credit demand. Based on the available funds provided by the government, the VBP in Hanoi makes a decision on how much of the fund to allocate to each district (Theesfeld 2000). The district branch of the VBP is informed about the decision. Thereafter, a body of experts[18] decides how much of the granted credit fund is allocated to each commune. The decision of the body is based on a recommendation of the head of the VBP at the district level (Chan 2001). The recommendation for the allocation at the commune level depends on the number of poor (hungry) households and the prior repayment discipline in these communes (Bao 2001).

4.3 Loan application procedure

Figure 1 describes the nine-step procedure to acquire a loan from the VBP. While the head of the district branch of the VBP in Ba Be (Bao 2001) states that the credit officer has to screen and monitor each household during several visits, the reality is that the credit officer does not normally visit the households. In reality, he visits the village and the CGL during the credit application process to gather secondary information about the applicants. The credit officer relies totally on the commune and village officials to assess the credit worthiness. After the disbursement of the credit to the group members, the credit officer may verify with the CGL whether the group members use the credit as stated in the loan application. Normally he trusts in the report of the CGL (giving him room for opportunistic behavior) and does not monitor the credit directly. Basically, not bank staff but persons outside the bank are involved in the monitoring: the head of the commune and CGL (see Figure 1).

During discussions with the commune heads and the CGL, however, they admitted that this is not a regular activity. Officially, the loan ought to be repaid immediately if it is not used as stated in the credit contract. Nevertheless, farmers pointed out that as long as they pay the interest and the principal in due time, the credit officer and the other local authorities do not bother about the actual use of the credit. This was also confirmed by credit officers in Ba Be district. The principal-agency relationship and the delegation of tasks has given wide room for moral hazard in the sense of a fungible use of the loan.

Step 5 of the loan application process (see Figure 1) relates to the role of the head of the commune in this process. If the head of the commune approves the households in the application, the credit officer will almost always follow his recommendation. Since the head of the VBP complies with the credit officer’s proposal, this implies that the head of the commune is actually the decisive power in the application process. The powerful position of the head of the commune in the VBP credit application process of households was also pointed out in earlier research on Ba Be district (Theesfeld 2000). Since physical collateral is ot required for VBP loans, the approval of the head of the commune can be considered social collateral according to Vaessen (2001). Local information sources in the form of key informants can be important low-cost mechanism to reduce screening and enforcement costs. Too much dependence of a bank on local networks as sources of information and recommendation, however, can have negative effects in terms of social exclusion of those

[17] The guidelines of the VBP for the credit estimation procedure propose that the PRB of each commune compiles a quarterly credit demand plan (VBP 1998). These plans are handed to the VBP at the district level, where the provincial demand is calculated. However, in the Ba Be district, the PRBs of the communes do not support the VBP in compiling such a demand plan (Theesfeld 2000).

[18] The body consists of three experts from the district level: (1) Vice-head of the peoples committee, (2) head of the PRB, and (3) head of VBARD.

households not included in the social and political network in the territory (Karlan 2001; Vaessen 2001). Particularly the very poor households find themselves often in this position. Besides, they are lacking access to fruitful relationships with powerful allies (Hickson 2001).

Figure 1 The nine-step procedure to get a loan from the VBP

1. Build a group of at least five people (in rare exceptions also four people are sufficient)
2. Elect a CGL (usually the one who started the group formation will become the leader)
3. Go (CGL) to the district VBP in order to buy the application forms from the credit officer who is responsible for the commune
4. Fill (group members) in the credit application forms
5. Submit (CGL) the forms to the commune and get the approving signature and stamp of the head of commune and of the chairman of the PRB (part of the screening process) [1)]
6. Bring (CGL) the forms back to the bank [2)]
7. Go (CGL) to the bank and take the loan booklets for each member (the loan booklets summarize the loan terms and is used by the credit officer to record the interest and principal payments)
8. Bring (CGL) the loan booklets back to the commune and get another recognizing stamp and signature of the head of commune and of the chairman of the PRB (submits them to the monitoring process)
9. Bring (CGL) the booklets back to the bank and wait for the disbursement of the loans (credit officer disburses the loans to the credit group members during a meeting in the commune or village)

Source: Own data, Rural Finance Survey (2001)

Note: 1) The signature also confirms that the applicants belong to the target group. The head of the commune my decide to exclude an individual household from the credit application if he knows of a disagreement between married couples as it relates to the credit application, in cases of drug abuse of the applicant, or so-called social evil in the households.

2) The approval procedure of the application are the following: (i) the credit officer signs the credit application which is synonymous to his approval and (ii) the head of the VBP cosigns the contract. Normally, the head of the VBP follows the decision of the credit officer.

The timeframe for this procedure varies between two weeks and nine months in the case of the research villages.

4.4 Back- and forward information flows between VBP, local authorities and households

Preliminary findings indicate that information on financial services is insufficient in rural Vietnam. The population is often not aware of the eligibility conditions for loans, interest rates, and other loan terms. The Vietnam-Canada Rural Finance Outreach Project (1999) states that information about credit is mainly conveyed via credit officers and is usually inconsistent. In this work it was found that the credit officers plays only a minor role in the dissemination of credit information.

According to VBP staff and local authorities in the research area Ba Be, sufficient credit funds are available to cover the effective demand of the poor target group. Therefore, the knowledge of how to exploit these funds seems to be more important than the knowledge about their availability. As discussed above, the VBP lends only to credit groups. Thus, the better the target group is aware of setting-up and managing a credit group the greater is the probability of getting timely loan approval. However, villagers are still reporting that loans are not always available at the VBP. Hence, the timely knowledge of available funds is still crucial for access.

4.4.1 Formalized information channels

Flows to the household. In one line of information, the head of the VBP informs the head of the communes and the chairman of the PRB at commune level about the credit terms but not about the total amount of available funds which was allocated to their commune. Subsequently the head of the commune decides which mass organization, respectively their members, will benefit of the allocated credit fund. The head of the commune conveys this information to the village leaders at a commune meeting or, sometimes directly to the villagers during a village meeting. Figure 2 displays the structure of the formalized information flux regarding credit availability from the VBP to the target group. The head of the village is responsible to invite all villagers to this meeting. But not every household receives an invitation. This may have several reasons: (1) the village head has a personal dislike against a certain household, (2) the household is remote and the head is reluctant to go that far every time, or (3) he simply forgot to inform a particular household. In one village some households even complained that they get never invited. Those households lack access to important information. Reasons (1) and (2) are clearly related to the principles of NIE as discussed in Section 2. Reason (1) has to do with opportunistic behavior on the side of a principal vis-à-vis a potential agent. Distance to a potential agent is closely related to the reduction of TCs argument.

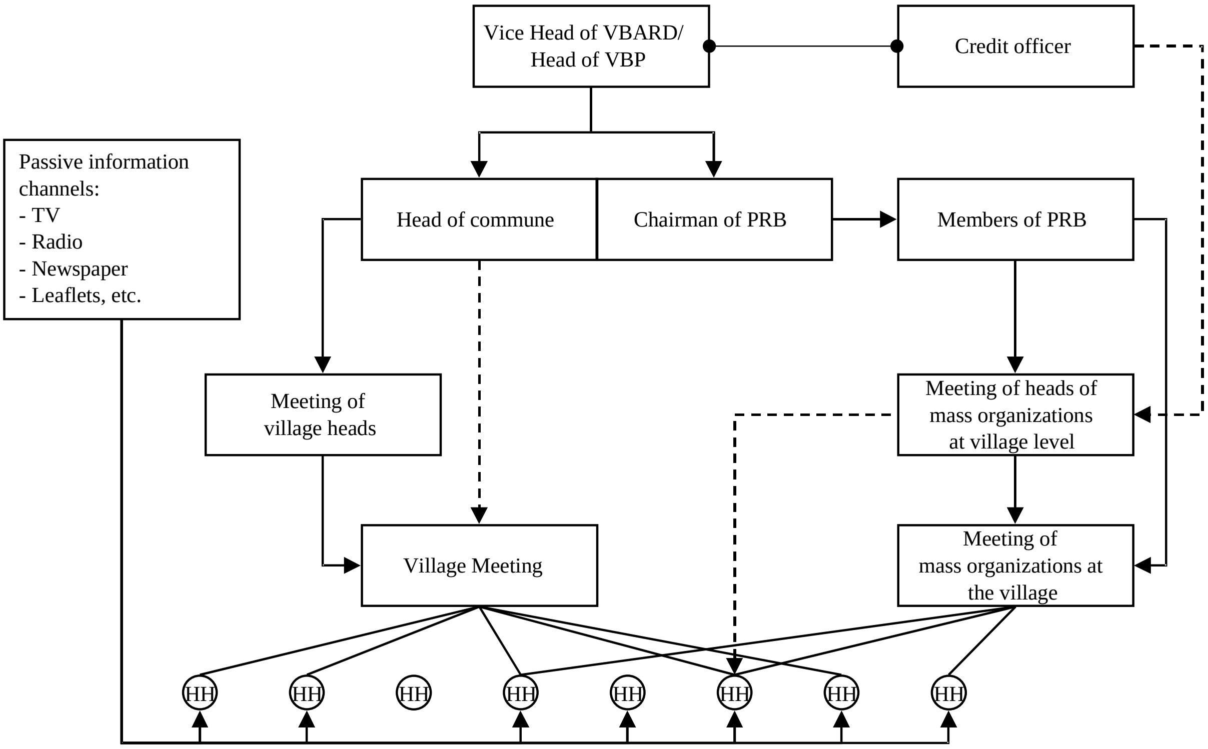
In the other line of information, the chairman of the PRB of the commune informs the members of the board.[19] The members of the Board, who are usually heads of mass organizations, convey the news to the village-based heads of their respective mass organizations during regular meetings (see Figure 2).[20] While the meetings of the local authorities at the commune level are relatively regular this does not apply to the meetings at the village level.[21] Clearly, the irregularity of the meetings could cause a loss of information, thus increasing TCs. However, most farmers turn to the heads of the mass organizations at the village level when they are planning to apply for a loan. The quality and the speed of the information flow from the commune to the household level thus crucially depends on the leadership and management capabilities of the local authorities at the commune and village level. This human capacity could be improved through training.

It is the credit officer's responsibility to visit the communes two or three times per month on a fixed date to collect the principal and the interest of the credit groups. These dates should ideally coincide with the market days in the commune (Bao 2001). The credit officer should inform the commune head and the PRB about his next visit. However, there is normally no direct information flow from the credit officer to potential borrowers as in reality, the dates of these visits are either not known by the population or these visits do not follow a time schedule. The Vietnam-Canada Rural Finance Outreach Project (1999) also found that the time schedule of the credit officers' visits was not known to the farmers. However, female credit officers tended to do a better job as this issue is concerned. Obviously, the VBP relies on the trickle-down effect of information from local authorities and CGLs to the households.

[19] Often, the head of the commune and the chairman of the PRB are one and the same person.
[20] The role of the mass organizations is to exert permanent pressure on their indebted members, i.e. the borrowers are regularly reminded to pay their debt.
[21] It should also be kept in mind, that each mass organization organizes its own meeting and the farmers and women's union exist in every village.

This trickle-down process is bothered with bottlenecks, or in other words gatekeepers, as described above and, therefore, crucial information may be stuck, diverted, or lost.

Figure 2 Formalized information flows



Source: Own illustration.

Note: The arrows indicates the direction of information flow. Broken lines indicate irregular information flows. Often the head of commune and chairman of the PRB are one and the same person.

After having submitted a credit application, the credit group has to wait for the decision. In case the application is denied by the head of the commune, he is not obliged to inform the applicants about the reasons. Theesfeld (2000) reports for instance, that the head of a commune uses a coded signature for the application form. Depending on the code, the credit officer knows whether or not he agrees to the applicant. This lack of transparency has two negative effects: First, there is no scope for improvement of the credit group's application (TCs remain high on the side of the credit group). Second, the group members may become frustrated and hesitate to apply a second time, because they already invested time and effort without any benefit and not knowing what went wrong (TCs for a transaction that did not occur on the side of the potential credit group and opportunistic behavior on the side of the head of the commune).

Flows to the VBP. The only direct formalized information flow from the household to the VBP is the submission of the credit application form. The fact that the bank receives the application form demonstrates that the application has already passed successfully two screening levels. The first screening takes place when the credit group is formed and the second when the application is signed by the head of the commune. The application forms also contain a section on the planed investment to evaluate the creditworthiness. The farmers normally know which loan financed investments are likely to be approved. Only a limited range of "obvious" or "fashionable" purposes related to agricultural production (e.g. rice cultivation, pig raising) will be approved by the bank. There is not much room for innovative or idiosyncratic proposals (UN 1998; Vietnam-Canada Rural Finance Outreach Project 1999). As discussed earlier, while the credit purpose is screened it is not monitored by bank staff later on.

Beside the information provided in the credit application form, the VBP uses commune authorities to assess the creditworthiness of potential clients. This approach of external screening is a reaction to the information asymmetry which exists between the credit officer and the local population. As the local authorities have more intimate contact to the local population they can better judge their creditworthiness. This procedure ought to reduce the information gap between credit officers and borrowers and thus reduce TCs and improve the repayment rate (Hgrindle 2001; Hoff and Stiglitz 2001). However, this approach can cause principle-agent problems between the credit officer (principal) and the head of commune (agent). As we discussed earlier, the head of the commune has a strong influence in the outcome of the screening process. Good contacts to the head of the commune can bias his decision in the loan screening process towards a particular household which may not fulfill the eligibility criteria of the VBP.

While the VBP has already incorporated several measures to reduce information, negotiation and enforcement costs (Randolph and Ndung'u 2000) in the rural credit intermediation process, these measures still give room to opportunistic behavior of the principals involved and moral hazard of the agents. Better rules on the side of the credit officers and more appropriate incentives of the non-staff resource persons involved in the credit allocation process could reduce TCs and lead to more equity in the credit allocation.

4.4.2 Non-formalized information channels

Flows to the household. Local authorities, such as the commune head, who possess insider information when one of the credit funds are made available by VBP, are functioning as so called 'gatekeepers'. Those households which have the information of when, where and how the loan funds are made available, have a major advantage in exploiting this source by appropriate signaling. Clearly, this information is rather given to households which are belonging to the social and political network of one of these gatekeepers (Bao 2001).

The village heads confirmed that one can always find households which can not translate their demand into effective access to credit. Those households might not be creditworthy and/or are excluded from the intra-village-information-networks (Theesfeld 2000). Nevertheless, the 15 CGLs in this research claim that all villagers could participate in their credit groups. They point out that they informed the whole village about their intention to set up a credit group. This would imply that the groups are heterogeneous in their membership. Nevertheless, in thirteen of the 15 credit groups in the research area, the members were neighbors or relatives of the CGL. This observation also supports the hypothesis that social ties are crucial for credit access Hoff and Stiglitz 2001).

Flows to the VBP. The head of commune does not know all households in his commune personally. He inquires with the CGLs, the village heads, heads of mass organizations, the security chiefs and other villagers about the individual households of a potential credit group. The credit officer interviews the same key persons. Again, this may cause agency problems. In this case, the head of commune and the credit officer are the principals and the village key persons are the agents. Households which keep good relations to these key persons have a better reputation than those who do not. One result of this may be, that some households gain access to two loans from the VBP (e.g. father and son), which is not allowed. This of course works only if the village authorities tolerate this (Bao 2001).

5 Conclusion and policy recommendations

The VBP was once founded due to the fact that rural poor households in Vietnam did not posses any collateral and, therefore, could not get credit from the VBARD. Today, many households which receive loans from the VBP, have collateral in form of land use rights (so called ‘red books’ or ‘green books’) and some farmers even switched from the VBARD to the VBP despite having collateral and not belonging to the eligible target group of the VBP. This is because of lower interest rate at the VBP. One can almost use the term ‘cannibalization’[22] for this fact. This marketing strategy can affect the sustainability of both institutions.

The analysis has shown that financial information flows of the VBP are fuzzy (in the sense of a credit application having different outcomes depending on the intermediaries of information involved)) despite an extensive formalization of the channels. The use of the above mentioned local authorities in the client screening and monitoring process is in principle a good strategy for reducing information asymmetry and thus TCs. Nevertheless, the involvement of these crucial information gatekeepers at different administrative levels, namely the credit officer, head of commune, members of PRB, village head, and the CGL, may impede, divert, and attenuate the dissemination of information. These gatekeepers normally belong to the same or related social and political networks. The information collected during group discussions in the research communes confirm Vaessen (2001), namely that the key informants of a FFI in a certain region should not all belong to the same network. This way, the FFI can avoid to fall into the trap of lending solely to a certain network of people, while the households outside this network are excluded (Vaessen 2001). Key informants from other networks could be from non-governmental organizations or self-help groups. But so far these groups are not found in the research area. One attempt to open new networks could be to employ credit officers of different ethnic minorities. So far 95% of the credit officers in Ba Be are belonging to the Tay minority. The remaining 5% are Kinh (Vietnamese). A more ethnical diversification of employees could also diversify the networks of information.

Another way to make the available information more transparent to potential borrowers could be the establishment of local information centers. This could be the communal post office where the VBP could arrange an information corner with leaflets. This could be combined with the introduction of a fixed day every week (or biweekly), which all commune members should be made aware of and where the credit officer is available for questions and discussions. This would allow the farmers to seek information and advice directly from a professional. Officially the credit officers are already following such fixed visiting schedule. Nevertheless, they do not stick to it as discussed above. If the VBP succeeded in asserting this policy, it would improve the service without increasing the TCs.

As the above analysis has shown, the use of a complicated poverty measurement system that (1) involves the same local authorities who decide over credit access of the poor and (2) lays the base for the eligibility of households to VBP loans, creates agency problems and is open to nepotism. Instead of using the current system to measure poverty, one could use the land register as a much more objective criteria for the target group identification. Those households who possess documented land-use rights should automatically be excluded from

[22] Cannibalization in this context refers to the lost sales of its own products that an institution suffers when it introduces another product in the same market (Brand 2000). As the VBARD and VBP are two branches of the same bank and owner (the state) with different credit conditions, the term is applicable here.

the target group of the VBP as they can get loans from the VBARD too. Of course this should go with the equalizing of the interest rate of both banks otherwise it could be an incentive not to register the land to maintain the opportunity for the VBP's loans.

By way of summary, improving the top-down and bottom-up information flow in the credit market for the rural poor could not only significantly reduce the operation costs of the concerned FFIs but also increase market access of the poor target group with profitable investments.

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