The People's Credit Funds of Vietnam: A Prudentially Regulated Credit Cooperative Movement

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Abstract

Emerging from the collapse of its command economy Vietnam succeeded in creating a conducive policy environment and building a strong new credit cooperative system. The Government benefited from the experience of other countries, but replicated none. Instead it came up with an innovation: cooperative self-help under state control, seemingly a contradiction. The newly established People's Credit Funds (PCFs) are self-managed and self-financed; yet their success is due to the central bank: designing the new system, preparing its regulatory framework, providing training and supervision and enforcing prudential standards while abstaining from undue interference. Regulation and supervision have been the state's instruments for assuring good performance, avoiding the disaster of the previous credit cooperative sector. The network overall has proved resilient during the global crisis, but with some differences between the rural PCFs and their central fund which in addition to liquidity exchange also provides retail services in urban areas.

1. In search of a credit cooperative model: replication vs innovation

Credit cooperatives are a type of microfinance institutions which are, on principle, self-governed and self-financed. This at least is how they emerged in Germany in the mid-1800s (Seibel 2003) and spread from there to numerous countries. In Europe, North America and a few other countries such as South Korea they retained their character as self-help organizations and eventually became part of the formal financial sector. In Communist countries they were integrated into the command economy and lost their self-help character. In most developing countries they are held in high esteem by the government – so much so that the government has taken their governance into its own hands and generously supplied them with cheap money. This has rarely been to their advantage. In Asia, India and Indonesia are two countries where the government, with well-meaning interference, has undermined the health of a century-old movement, the majority of credit cooperatives now dormant or loss-making (Seibel 2009a). There is a dearth of developing countries that could serve as models for the construction or reform of a self-reliant and sustainable credit cooperative movement.

In this paper we present the case of the Vietnamese People's Credit Funds (PCFs): a self-help movement under effective central bank regulation and supervision in a Communist country. Within less than two decades Vietnam, emerging from the collapse of its command economy, succeeded in creating a conducive policy environment, captured some of the lessons of credit cooperative history and build a strong credit cooperative system. Yet, while Vietnam may serve as a model, it might be fatal if the Vietnamese credit cooperative system were simply duplicated. Every country faces the challenge of finding its own way in a given economic, cultural and political environment. In Vietnam, the Government examined the options, benefited from the experience of other countries, but replicated none. Instead it came up with its own innovation: People's Credit Funds (PCFs) as self-help organizations under state control, seemingly a contradiction. The case of Vietnam shows that the world of cooperatives is more complex than indicated by the simple dichotomy of successful self-help movements vs failing state-supported systems. The newly established PCFs are self-managed and self-financed; yet they are part of a movement in which the State Bank of Vietnam (SBV), the central bank, has been in the driver's seat from the beginning. SBV has been in charge of designing the new system; it prepared its regulatory framework, integrated the network into the formal financial sector, supervised its progress and enforced prudential standards. Yet SBV has abstained from undue direct interference and from using the PCFs as credit channels.

2. Creating a conducive environment

Since 1976 rural credit cooperatives were part of the command economy of Vietnam, numbering 7,200 by the mid-1980s. They collected small deposits and provided credit to production cooperatives, farm households and small state-owned enterprises (SOEs). (Boi & Hung 1992: 17-19) A continual decline in the production of rice and other commodities and, finally, hyperinflation led to the collapse of the economy including the credit cooperatives.

The Government responded to the crisis with a new policy, *Doi Moi* ("renovation"), aiming at the introduction of a market economy. In 1988 the mono-tier banking system was transformed into a central bank and four state-owned commercial banks (SOCBs). In 1989 this was followed by a policy of monetary restraint, with a dual focus on limiting credit supply to SOEs and raising interest rates to positive real terms. Economic reforms included a return to private enterprise and household farming. The impact on output growth and monetary stability was dramatic, without significant external support. (IMF 1990: 26; WB 1991: i),

The 1989 reforms revealed the weaknesses of the financial system, the four SOCBs being but arms of the SBV, and the SBV failing to carry out its policy functions. The Government thus moved on to new reforms. In 1990 a financial institutions ordinance was passed, providing a legal framework for a differentiated financial infrastructure: SBV as monetary policymaker and financial regulator, universal banks in government, private and partially foreign ownership, limited-service financial institutions and credit cooperatives. Subsequently credit cooperatives were placed under the law on cooperatives in 1996, the law on credit institutions in 1997 and the decree on the model statute and operation of the PCF in 2001, amended in 2005. In 1991 a banking decree accorded SBV supervision authority over the financial sector, including credit cooperatives. Of utmost important for the rural and agricultural population was a new land law in 1993 providing for land use certificates that can be sold, leased, inherited and mortgaged. (IMF 1990: 18-27, 58; Seibel 1992: 48-57; World Bank 1991)

With ups and downs, there has been remarkable growth over the past two decades. Private enterprise is now the backbone of the economy. Out of 12,000 SOEs, around 10,000 are fully or partially privatized. Most impressive has been the impact of Vietnam's new agricultural policy. Private land use rights have replaced collective agriculture; and free input purchasing and produce marketing have been substituted for administrative factor allocations. Harnessing the power of millions of smallholders as private entrepreneurs, the result has been an agricultural miracle. In 1989 Vietnam turned from a net importer to an exporter of rice; in 1993 it became the world's third-largest, and in 1996 the second-largest, rice exporter. It is now also a major exporter of coffee and a variety of other farm, forest and fisheries produce. Economic performance has been paralleled by social performance. Between 1990 and 2004 the percentage of the population living on $1 or less per day (at purchasing power parity) declined from over 50% to below 10%. Today 94% of households have electricity; almost all children attend primary school; nearly two-thirds stay on to upper secondary. Free enterprise, free trade and sensible state finances have been the key factors of transformation. Huge problems remain, among them a poor infrastructure, pervasive corruption and, as The Economist (2008: 4, 9) stated, "the glacial speed of legislative and bureaucratic processes".

3. Designing a regulated credit cooperative system

In 1991 a government team under SBV was formed to examine the options. It first ruled out credit cooperatives as agents of banks, as they would lack autonomy and viability. Next, the team visited the Grameen Bank in Bangladesh, cooperative banks of the Raiffeisen and Schulze-Delitzsch type in Germany, and the Caisses Populaires Desjardins in Canada. Finally, the team opted for a model of its own, decided on a pilot project, 1993-2000, and established steering committees at all administrative levels. Technical assistance has been provided by Développement International Desjardins (DID) from inception, by GTZ since 1999, and financial assistance by ADB since 1996.

To avoid any resemblance to the defunct system a new name was found: People's Credit Funds, cooperative in nature but not in name. The PCF network was designed to comprise three types of institutions: primary societies (established in 1993); a central fund (established in 1995) together with regional funds; and the Vietnam Association of PCFs (established in 2006).

SBV provides a regulatory framework, licensing and mandatory training services. Through its branches it supervises the performance and compliance of the PCFs. SBV has the authority of closing non-performing PCFs. Prudential standards include a minimum capital requirement of D100 million (equivalent to $17,000 in 1993, around $6,000 in 2008, increased for new PCFs to $30,000 in the provinces and $60,000 in Hanoi and Ho Chi Minh City at 2008 exchange rates), a risk-weighted capital adequacy ratio of 8%, a fixed asset ratio of at most 50% of equity, reserve requirements (placed interest-free at SBV) of 1% of Dong deposits

and 8% of US$ deposits, a single borrower limit of 15% of equity (up from 10% at inception), adequate maturity matching (at most 10% of short-term deposits to be used for term loans) and observance of SBV's provisioning rules. The appraisal process, collateral requirements, loan loss provisioning, record-keeping and reporting are also regulated by SBV.

PCFs are subject to three types of oversight: daily internal control; regular random inspections by the SBV branch; and remote supervision by the SBV supervision department. PCFs send their reports to the SBV branches which forward them to the PCF Division of the Supervision Department and the Credit Cooperative Institutions Department (CCI) of SBV. Online reporting is expanding, but not yet universal. Based on the monthly report, an SBV branch may intervene directly in case of irregularities or poor performance.

PCFs are voluntary organizations with at least 30 founding members. They are based on the principles of self-help, self-reliance, self-management and democracy. More concretely, they are formed by their members; self-financed through shares, deposits and retained earnings; professionally managed by a team of qualified employees under the control of a board; and the board is elected by the general assembly of members with equal voting rights. Unlike the former credit cooperatives, they are part of a network functioning as a nation-wide system of mutual support. The network provides model bye-laws and various apex services, including access to liquidity exchange and refinancing. 95% of the PCFs are rural. After an initial two tax-exempt years, PCFs are subject to income tax up to 28%, varying by province.

The board of directors consists of three to nine persons elected by the general assembly for a five-year term. Board members are usually experienced and respected citizens who played a leading role as founding members. The board decides on capital increases, interest rates within a range set by SBV, recruitment and expenditure. It also appoints the managing director, to be approved by the general assembly and confirmed by the SBV branch. The chairman of the board may also serve as managing director. A credit committee decides on loans exceeding the managing director's lending authority. Internal control is placed in the hands of a supervision committee elected by the general assembly.

Deposits are mobilized from members and non-members, comprising individuals and organizations. PCFs offer attractive conditions: proximity and easy access which entail lower client transaction costs; diversified products; higher deposit rates than banks; and term deposit insurance. Surplus deposits are placed at the CCF. Other financial services include bill payment and remittances. PCFs also act as trust agencies for development programs.

Lending is restricted to members in good standing; but PCFs may lend up to 10% of their portfolio to poor non-members. About 30% of the borrowers are women. The portfolio is diversified, comprising loans for agricultural production and processing, crafts, services, trading, consumption and emergencies. Procedures are kept simple. Most loans are secured, except small loans and loans to the poor. The most common collateral is land use and house ownership certificates – largely a formality as these are difficult to alienate. Both deposits and loans are mostly short-term.

Interest rates were liberalized in 2002; but PCF boards kept deposit rates high (around 8% to 9% p.a.) and lending rates low. As inflation rose from 6.6% in 2006 to 12.6% in 2007 and 22% in 2008, SBV returned to a restrictive (and ill-advised) interest rate policy, with ceilings set at 21% in May 2008, lowered to 16.5% in December 2008 and 11.55% in early 2009.

4. Growth of the People's Credit Funds

The pilot project started in July 1993 and ended officially in March 2000. During the start-up phase, 1993-1996, outreach grew rapidly, resulting in 847 PCFs with 370,000 members as of 1996. Total loans outstanding reached $91 million, deposits $60 million and equity $9 million.

The second phase, 1997-2002, is marked by the intervention of the supervisor. During 2000-02 SBV closed a total of 83 non-performing PCFs, based on the results of an evaluation at the end of the pilot phase. However, growth in membership was only slightly affected, while loans and deposits continued to grow at a low rate.

The current phase, since 2003, is characterized by three trends: cautious growth in the number of PCFs, with SBV closing about 3 PCFs per year until 2007 (none in 2008); continual growth in membership; and rapid growth in loans and deposits. By the end of 2008, the network covered 1015 PCFs with 1.35 million members. Total assets stood at $982 million, loans outstanding at $833 million, total deposits at $726 million (financing 87% of the portfolio), and equity at $46 million. (Table 1)

Table 1: The development of PCFs, 1994-2008 (amounts in million US$)

	1994	1996	1998	2000	2002	2004	2006	2007	2008
Outreach:									
No. of PCFs	179	847	977	959	888	905	938	973	1015
No. closed by SBV *)	0	0	0	5	77	6	8	2	0
No. of members	46,045	378,978	646,701	797,069	850,781	966,540	1,098,754	1,157,416	1,349,804
No of borrowers	n.a.	n.a.	734,796	711,769	660,361	661,663	732,774	785,638	785.698
Financial data:									
Total assets	7.6	120.81	133.74	184.2	232.14	371.01	585.98	850.71	982.17
Loans - gross	6.59	91.16	116.17	161.9	200.66	322.5	511.3	731.11	833.04
Deposits	5.01	60.26	85.63	117.85	153.97	250.05	389.65	582.47	726.24
Borrowings			19.62	22.34	39.77	63.36	106.7	152.98	131.83
Equity	0.98	9.05	11.03	11.96	13	19.53	28.52	38.55	45.88
Profit after tax	0.26	3.13	2.76	3.18	4.89	7.19	10.54	10.24	10.81
Financial ratios (in %)									
Overdues (≥1 days)	0.74	1.24	3.84	3.42	1.36	0.66	0.53	0.50	0.53
ROAA **)				1.17	1.43	1.40	1.30	0.87	0.79
ROAE **)				15	20	21	19	14	11
Deposits-to-loans	76	66	74	73	77	78	76	80	87
US$ exchange rate	*11,003*	*11,037*	*13,887*	*14,540*	*15,395*	*15,776*	*16,056*	*16,025*	*16,977*

Source: Based on data from SBV
*) The number of PCFs closed by SBV listed for 2002, 2004 and 2006 also include the preceding year.
**) As provided by SBV.

Figure 1 shows the rapid growth in the number of PCFs until 1996, the subsequent decline in the rate of increase when SBV closed many PCFs, and slow growth since 2003. Membership grew steadily, with a flattening of the curve in 2000 and a sharp incline in 2008.

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Figure 1: Number of PCFs and members, 1994-2008

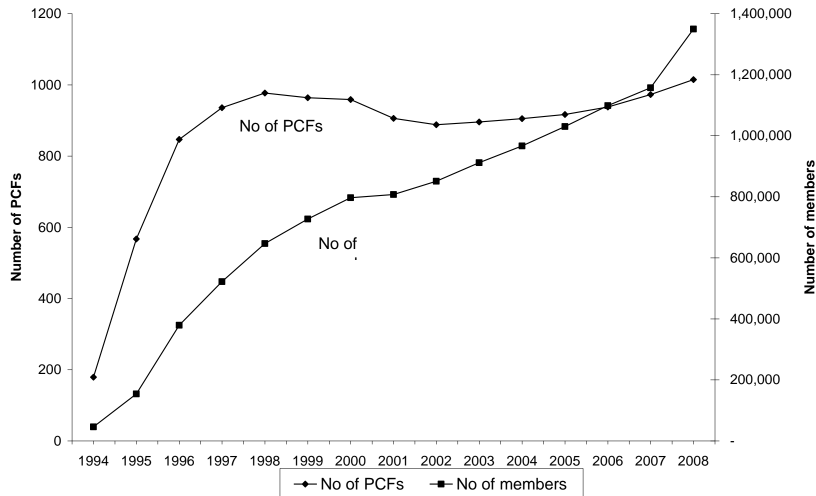
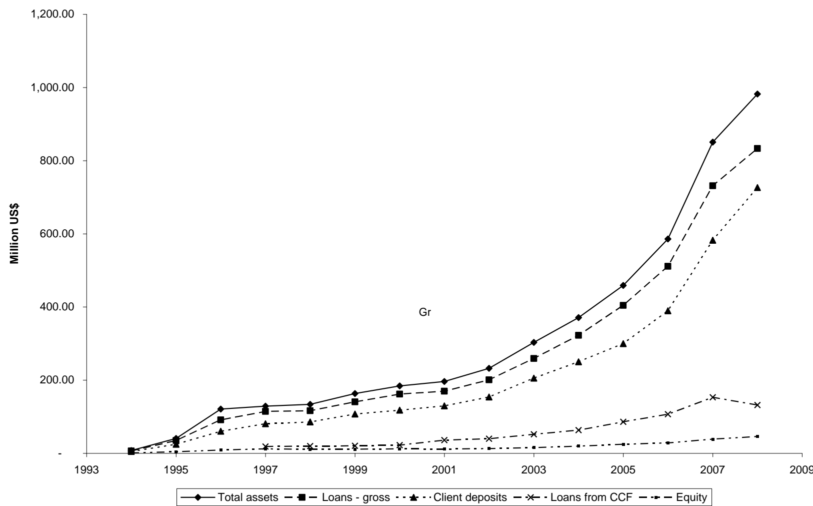


Figure 2 shows how loans outstanding and client deposits as the main source of funds have grown virtually in unison since inception, From 1994 to 1996 the curves grew steeply, followed by a flattening during the consolidation period. 2002 marked a turn-around to an increasingly steep incline, with total assets, loans and deposits more than doubling in US$ terms during the last three years. Growth of borrowings from CCF has remained far behind that of deposits. Equity has remained at a low level.

Figure 2: Total assets, loans outstanding, deposits, borrowings and equity of PCFs, 1994-2008



PCFs have grown more than five-fold in average membership, from 257 per PCF in 1994 to 1330 in 2008. Broadening of outreach has been accompanied by financial deepening.

Average deposit balances per member increased from $109 in 1994 to $538 in 2008. Average loans outstanding per active borrower increased from $169 in 1997 (the first year their number was reported) to $1060 in 2008.

Overall the PCFs have performed extraordinarily well, both in quantitative terms of growth and in qualitative terms of repayment. In 1994 and 1995 overdue ratios (late by one day or more) were well below 1%. In 1996 they climbed to 1.2% and went up to rates ranging from 3.4% to 3.8% between 1997 and 2000. During the second part of the consolidation period they declined and stayed at 0.5% during the last four years – proof of the effectiveness of consolidation. No doubt, it is not only the PCFs which have performed well, but also SBV as their supervisor.

Profit margins have been low, due to the policy of the PCFs to keep deposit rates high and loan interest rates low. Margins have been further reduced by the recent interest rate restrictions of SBV. Return on average assets (ROA) and equity (ROE) ratios are reported by SBV since 2000. Between 2000 and 2006 ROA fluctuated between 1.2% and 1.4%. In 2007 it declined to 0.87 and in 2008 to 0.79. Similarly, ROE started at 15% in 2000, climbed to rates between 18% and 21% and subsequently fell to 14% and 11%, respectively.

5. Growth of the Central People's Credit Fund (CCF)

CCF is a joint stock financial institution under the law of cooperatives, the law of credit institutions and the decree of 2001 on PCF. It was licensed by SBV in 1995 as the financial apex of the PCFs and falls under SBV supervision. CCF provides financial services to PCFs and the general public, including SMEs, farmers and CCF staff. In addition it provides technical assistance to PCFs and has been acting as focal point for the network in external relations. There are 25 branches operating as profit centers, providing substantial performance incentives to staff.

CCF is owned by the Government (as a special member represented by SBV), four state banks and the PCFs. Their representatives form the general assembly and the board of management. The legal capital as of 2007 amounted to $7.0 million, 73.2% of which were held by SBV. In 2008 SBV injected D600 billion (US$35.3 million), bringing its share to 95.8%, in preparation of its transformation into a commercial bank, CCF is governed by a permanent supervisory board of three and an executive committee of six members. The accounting system is largely in line with international standards. Reporting is based on a format issued by SBV. The accounting department prepares a daily balance sheet, sent to all departments. The branches submit their data daily, with automatic overnight inclusion in a consolidated report. Risk management pertains to four major risks: credit, liquidity, market and interest rate. An internal auditing department is under construction.

CCF accepts deposits from PCFs since 1998 and from the general public since 2001. In 2007 15% of total deposits came from PCFs, 40% from banks and 45% from other clients. CCF has been lending to PCFs since 1995 and to SOEs since 1998, in an effort to contribute to their viability. In 2001 CCF introduced consumer lending to individual clients. 52% of its portfolio is extended to PCFs, 7% to SMEs and 41% to individuals. 73% of the loans are short-term, 25% medium-term and 3% long-term. 84% of the portfolio is financed from own resources, 16% from donor credit lines. The feasibility of a life insurance product for loan protection is under study.

Interest rates in August 2008 stood at 4.8% p.a. on current accounts and 17.5% to 19.2% on term deposits. Lending rates varied from 16.8% to 21.0% on loans from own funds and from 13.2% to 19.8% on loans from project funds. The net interest rate margin was 2.95%. PCFs pay the lowest, individuals the highest interest rates. Due to interest rate uncertainty long-

term loans (with an overdue ratio of 0.9%) were more expensive than short-term loans (with an overdue ratio of 1.5%).

There are two major phases in the evolution of CCF: a phase of slow growth from 1995 to 2000, the end of the pilot project, during which the refinancing function of the CCF was paralleled by Regional Credit Funds (RCFs); and a period of rapid growth from 2001 to 2007, initiated by the merger of the RCFs with the CCF and the provision of retail financial services to the general public. The trend changed in 2008, which is discussed in the next chapter. During 1995-2000 the average annual growth rate of loans outstanding was 69%; during 2000-2007 it surged to almost 150%. Deposit-taking started in 2000 near zero; hence meaningful comparative percentages of growth cannot be calculated. In 2007 deposits accounted for a remarkable 96% of loans outstanding. Equity grew during the two periods at an average of 0.3% and 7%, respectively. Growth rates of borrowings declined by 9/10th, from 513% to 54%, as borrowings were largely replaced by deposits. (Table 2)

Table 2: Increases of core balance sheet parameters of CCF, 1995-2000 and 2000-2007

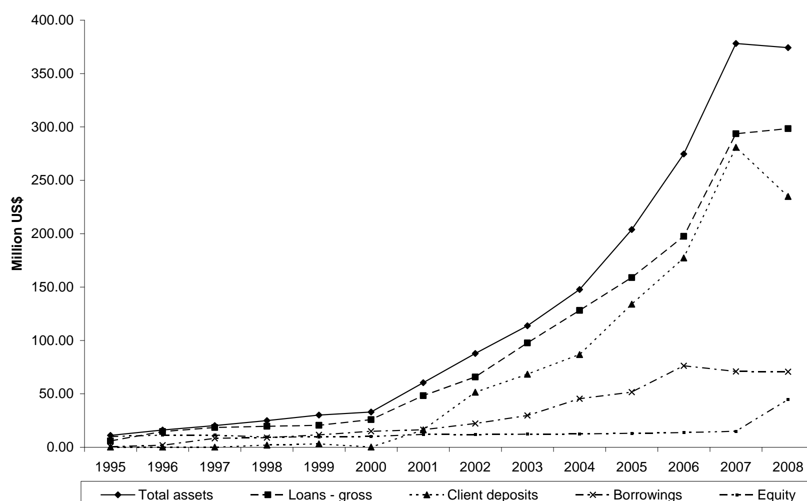
	Balance sheet data (in million US$)			Av. annual growth rates (in %)	
	1995	2000	2007	1995-2000.	2000-2007
Total assets	11.00	32.99	378.04	40	149
Total loans gross	5.78	25.79	293.51	69	148
Total deposits	0.00	0.15	280.83		
Total borrowings	0.56	14.91	70.98	513	54
Total equity	9.98	10.11	14.89	0.3	7

Source: CCF data

The turn-around of CCF in 2001 led to a fundamental change in the structure of the balance sheet. Comparing percentages in terms of total liabilities and capital in 2000 and 2007, deposits surged from 0.5% to 74%, borrowings fell from 45% to 19%, and total equity dropped from 31% to 4%. This is paralleled by a decrease in the percentage of loans outstanding to PCFs in terms of total assets from 68% to 40%, and an increase of loans to other clients from zero to 37%. The overall result of the transformation has been a savings-driven institution with a diversified portfolio. Self-reliance through deposit mobilization has been the most outstanding outcome. In 2007 CCF stood at 44%, and in 2008 at 38%, of the consolidated total assets of the PCFs.

Graphically the turn-around is shown in Figure 3. All curves up to 2000 indicate very low growth rates. In sharp contrast, during 2001-2007, there has been a more than ten-fold surge in total assets and loans outstanding (measured in US$); deposits grew from 7% of loans outstanding to almost 100%. Only the curve of total equity remained flat, with a growth of less than 50% over the seven-year period until 2007 (but over 400% by 2008 after a capital injection by SBV).

Figure 3: Total assets, loans outstanding, deposits, borrowings and equity of CCF, 1995-2008



The performance of CCF has been satisfactory. Overdue ratios have been moderate: they were near zero during 1998-2000, the first three years for which data exist, when CCF only lent to PCFs and RCFs. With the beginning of lending to the general public in 2001, the overdue ratio (≥1 day) went up from 0.25% to 2.05% and oscillated subsequently between 1.0% and 2.9%. In terms of profitability the best-performing years were 1996 and 1997: a liberal era in which the net interest margin was above 8%, the ratio of operational expenses over operational income around 40%, and ROA above 7%. Since then the net interest margin has been a modest 3% to 4% and declined to 2.95% in 2007, the lowest ever. From 2000 to 2007 net interest income grew by more than 900%; but efficiency went down as costs surged, and ROA came down from around 2% in 1998-2000 to 0.4% during 2005-07. In the inflationary environment of 2008, SBV does well to impose a tight money policy. But a cap on interest rates – in an effort to keep inflation low – is the wrong instrument. This puts the health of an otherwise sound credit cooperative sector at risk.

6. Growth and resilience during the global crisis

The PCF system has mastered several challenges since its establishment in 1993, including the Asian financial crisis in 1997/98 and the closing of nearly 100 poorly performing PCFs by the central bank at the conclusion of the pilot phase. It is now facing a new challenge: a test of resilience under conditions of a global financial and economic crisis, which presents a real threat as Vietnam has been increasingly integrated into the world economy. There are two aspects to this test: the first pertains to the PCFs as local financial institutions with a rural membership of predominantly small savers and borrowers. The second aspect pertains to their apex, the CCF, which also provides financial services to the general public, mostly in urban areas. One may expect that the two types of institutions differ in their exposure to the global crisis and perhaps in their resilience.

The global financial crisis began in July 2007 in the US with a loss of investor confidence in securitized mortgages; it spread and intensified throughout 2008 and turned into a global economic crisis. Vietnam's export-driven economy was affected by a downturn of global demand and inward investment. The economy was not shattered, it expanded by 6.18% in 2008; but this was the lowest level in almost a decade.

In 2008, the year when field research for this study was conducted, concerns were voiced that the crisis might seriously affect the microfinance industry worldwide. We surmise that effects will vary widely, depending, among other factors, on the self-reliance of institutions and their exposure to the inflow of external capital. As the crisis spread, the question arose whether and how it affected the PCFs. PCFs are financed through member deposits as their main source of funds (87% of loans outstanding in 2008). Other sources of funds comprise member shares and retained earnings. At 13%, loans from CCF are but a fraction of liabilities and capital. When requesting an update until December 2008, our hypothesis was that impact would be quite limited.

However, economic reality is complex, and there are other factors at work. Inflation in Vietnam increased from 6.6% in 2006 to 12.6% in 2007 and surged to 22% in 2008. As in many other developing countries, this was initially due to rising food and energy prices, unrelated to the crisis. Subsequently inflationary pressures might have been increased by the crisis, while food and energy costs declined in the second half of 2008. The possible impact of inflation on PCFs has been exacerbated by the central bank's attempt to stem inflation with interest rate ceilings. As a result, interest rates in 2008 turned negative in real terms, last seen in 1989. The question of resilience is thus a wider one: how did PCFs fare under the combined onslaught of global crisis, inflation and financial repression?

With regard to CCF, the situation might be different. CCF derives only 13% of its liabilities and capital from PCFs; the main source of funds are deposits by other, mostly urban, clients (50% of total liabilities and capital in 2008). Borrowings account for 19% and equity for 12% of liabilities and capital. Both types of institutions, PCFs and CCF, are savings-based; but they differ in that PCFs fully rely on local rural markets, while CCF is to a considerable extent integrated into urban markets and thus more exposed to wider domestic and global influences. Does this show in its performance during 2008?

The PCF network expanded by 4.3% in 2008, more than in the preceding years; for the first time since 2000, no PCF was closed by SBV. Membership grew by an unprecedented 16.6%; but the number of loans outstanding stagnated, due to perceived uncertainty (Table 1, Figure 1) – a similar reaction as experienced by the Microbanking Units of Bank Rakyat Indonesia in 1998 (Seibel 2009b). In US$ terms growth continued at an impressive rate as visualized in Figure 2. Total assets grew by 15.5%, loans outstanding by 13.9%, deposits by 24.7% and equity by 19.0%. Yet growth rates in 2008 are lower than those of 2007; but these were exceptionally high compared with already high growth rates in previous years. Borrowings increased by 43.4% in 2007 and decreased by 19.0% in 2008: mostly due to lesser loan demand. (Table 1) The decline in borrowings is a result of investor prudence; it is not due to a drying up of international funds as a result of "capital constraints endemic to the financial market meltdown" (Rosta 2009); in fact, international borrowings increased by 16.9%, far more than in previous years.

Table 3: Growth rates of PCFs, 2005-2008 (in percent, based on US$)

	2005	2006	2007	2008
No of PCFs	1.3	2.3	3.7	4.3
No of members	6.6	6.7	5.3	16.6
No of borrowers	1.4	9.2	7.2	0.0
Total assets	23.6	27.7	45.2	15.5
Loans - gross	25.4	26.4	43.0	13.9
Deposits	19.9	30.0	49.5	24.7
Borrowings	35.7	24.1	43.4	-13.8
Equity	25.2	16.7	35.2	19.0

Source: Own calculations, based on SBV and CCF data

The overall economic situation apparently did not have an impact on the ability and willingness of PCF members to repay their loans: for the past four years, including 2008, the overdue ratio (≥1 day) stayed at 0.5%. The financial performance of PCFs deteriorated in 2007, a trend which continued into 2008: ROA fell from 1.30% in 2006 to 0.87% in 2007 and 0.79% in 2008, ROE from 19% to 14% and 11%. (Table 1) The decline in profitability in 2007 and 2008 was mainly due to two factors: a more conservative provisioning policy of SBV and stronger competition which kept PCFs from lowering their deposit interest rates. As a result net income after tax stagnated and failed to keep pace with portfolio growth. Compared to that, interest rate restrictions as of May 2008 had surprisingly little additional impact.

The growth pattern of CCF from 2001 to 2007 has been overwhelmingly positive and similar to that of the PCFs, with growth rates of CCF overall somewhat higher, as visualized in Figures 2 and 3. The pattern in 2008, however, is fundamentally different. The growth of total assets, at 37.7% in 2007 (and similarly high rates in the years before), came to a standstill, at an unprecedented -1.0%. Similarly, the growth of the loan portfolio fell from a spectacular 48.6% in 2007 to 1.7% in 2008. Deposit growth fell even more dramatically: from 58.4% to -13.8%.

The two client groups of CCF reacted differently to the economic situation in 2008: the PCFs deposited more in the CCF and borrowed less; other (mostly urban) clients deposited less and borrowed more; but the change is not dramatic. (Table 4) From 2007 to 2008 the growth rates of deposits by PCFs fell from 90.2% to 14.1%, compared with respectively 53.9% and -21.8% of deposits by other clients; growth rates of loans to PCFs fell from 43.4% to -13.8%, while growth rates of loans to other clients fell from 54.7% to 18.5%.

Unrelated to the crisis, the rate of growth of equity surged from 8.6% in 2007 to an astronomical 199% in 2008. This is owed to a substantial investment by SBV, which brought equity up from $14.9 million to $44.6 million, presumably in preparation of the Fund's transformation into a commercial bank. The capital adequacy ratio (CAR, risk-weighted) surged from an all-time low of 10.1% to 30.9%.

Donor credit lines have risen continuously since 1997; and there has been no drying up in 2008. During the last three years they not only rose in absolute terms, but their growth rate also went up: from 9.1% in 2006 and 12.3% in 2007 to 16.9% in 2008, reaching $65 million. This was accompanied by a reduction of domestic debt of CCF, which declined from $20.6 million in 2006 to zero in 2008.

Table 4: Growth rates of CCF, 2005-2008 (in percent, based on amounts in US$)

Balance sheet	2005	2006	2007	2008
Total assets	38.0	34.7	37.7	-1.0
Total loans gross	23.9	24.4	48.6	1.7
Loans to PCFs	*35.7*	*24.1*	*43.4*	*-13.8*
Loans to other clients	*12.5*	*24.7*	*54.7*	*18.5*
Total deposits	54.4	32.4	58.4	-16.4
Deposits of PCFs	*1.7*	*43.7*	*90.2*	*14.1*
Deposits of other clients	*65.6*	*30.9*	*53.9*	*-21.8*
Total borrowings	13.7	47.6	-6.8	-0.4
Domestic borrowings	*-93.3*	*9,266.1*	*-54.9*	*-100.0*
Donor credit lines	*26.4*	*9.1*	*12.3*	*16.9*
Total equity*	4.3	5.7	8.6	199.2

*The growth rate in 2008 is due to a capital injection of US$35.3 million by SBV.
Source: Own calculations, based on SBV and CCF data.

Overall the impact of the turmoil in 2008 on the financial performance of CCF has been moderate. Since CCF started lending to the general public overdue ratios (≥1 day) have

been fluctuating between 1% (2004) and 2.9% (2005). In 2007 CCF had succeeded in bringing the overdue ratio down to 1.3%; but in 2008 it jumped to 3.1% - evidence of repayment problems, but still at a moderate level (particularly in light of the strictness of the definition). Efficiency as measured by the ratio of operational expenditure over operational income declined slightly, from 68% to 73%. Under pressure to charge “affordable” interest rates, ROA, unadjusted for inflation, has been historically declining from 7.8% in 1996 to values below 1% after 2001, stabilizing at 0.43% between 2005 and 2007. In 2008 ROA continued its slide to 0.37%.

7. Conclusion

Within less then two decades Vietnam, emerging from the collapse of its command economy, succeeded first in creating a conducive policy environment, then capturing some of the lessons of international credit cooperative history, and finally building a strong new credit cooperative system. The Government had the options examined, benefiting from the experience of other countries, but replicating none. Instead it came up with its own innovation: cooperative self-help organizations under state control, seemingly a contradiction. The case of Vietnam shows that the world of cooperatives is more complex than indicated by the simple dichotomy of successful self-help movements vs failing state-supported systems. The newly established PCFs are self-managed and self-financed; yet they are part of a process in which the central bank has been in the driver’s seat from the beginning. SBV has designed the new system, prepared its regulatory framework, provided guidance and training, supervised its progress and enforced prudential standards. Yet SBV has abstained from undue interference and from using the PCFs as credit channels. Prudential regulation, effective supervision and insistence on compliance have been the state’s instruments for assuring good performance, avoiding the disaster of the previous credit cooperative sector.

The PCFs have mastered several challenges since their establishment in 1993, including the Asian financial crisis and the closing of poorly performing PCFs after the pilot phase. They are now facing a new challenge: a test of resilience under conditions of a global financial and economic crisis, a real threat to Vietnam as it has been increasingly integrated into the world economy. There are two aspects to this test: the first pertains to the PCFs with a rural membership of mostly small individual savers and borrowers, the second to the CCF, which manages liquidity exchange for the PCFs but also provides financial services to the general public in urban areas.

PCFs with their rural clientele proved resilient. Loans outstanding and deposits continued to grow almost unimpeded at high rates. Only the number of loans stagnated as some members worried about the future. Also, members honored their repayment obligations, with overdue ratios constant near zero. The central bank’s attempt to control inflation (related to a prior rise in food and energy prices) by imposing interest rate ceilings barely indented the (rather low) profits of the PCFs. Earnings had been more affected by a more conservative provisioning policy in 2007, which carried over into 2008, and by competition, which prevented PCFs from lowering deposit rates.

CCF, in contrast to PCFs, also serves urban corporate and individual clients and relies largely on their deposits. Since CCF began serving the public, its growth has been spectacular, exceeding that of the PCFs, but only until 2007. In 2008 growth of total assets and loans outstanding came to a standstill; deposits declined. Exposure to urban markets, previously a strength, now turned into a liability. Yet, in terms of financial performance CCF has coped rather well. Overdues went up, but not to an alarming degree. Efficiency went down slightly, and so did profitability. Overall the credit cooperative network as a system has demonstrated that reliance on savings and responsible finance supervised by the central bank have been an engine of growth, resilient at times of crisis.

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