Comparative Analysis of Innovation between Vietnam's Microfinance System and International Benchmarks

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Abstract: Microfinance is seen as an appropriate solution to poverty in developing countries. However, its development is not in a single model for all countries. The poor in different countries are facing different circumstances, which generate different demands for financial products and services. Though in the beginning of microfinance establishment, all governments provide funding to help the existence and development of the microfinance programs, this is not the manner that can transform microfinance into an integral part of the national financial system and provide financially independent and long-term growth to microfinance institutions. The differences in the financial characteristics and needs of the poor in the countries, and the development of the microfinance sector itself, have made governments opt for their own solutions to develop microfinance. Although it is impossible to build a single formula for the development model of microfinance, it is helpful to compare the innovation of Vietnam's microfinance system with two globally famous systems, namely Grameen Bank and the Bank Rakyat of Indonesia (BRI). Besides the lessons learned from the success of large international microfinance organizations, comparative analysis of microfinance implemented in different environments with different methods help find the answers for research questions: which models of microfinance institutions suit certain socio-economic conditions, and what is better - developing non-profit microfinance or that of commercial purposes in the context of Vietnam.

Keywords: microfinance system, innovation, Vietnam.

1. Introduction

The appearance of microfinance has been a panacea for many social ills rooted in poverty. However, it is not a standard solution in the kind of "one size fits all" to worldwide underdevelopment and poverty. As the concept of "one political state, one language and one culture" which has been existing and theorized long time ago since the birth of a nation state in French revolution, each country has its own socio-economic-political-legal context, a unique culture, a distinctive dominant ideology, a special set of values and a governance structure, thus, poor people there have to face different poverty demands with diversity challenges and threats. In the beginning when microfinance just emerged,

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most governments acted the same as actively supporting the survival of microfinance through lending programs with direct or indirect subsidies. However, the rapid development of microfinance sector as well as the new transition of microfinance toward profitable commerce have led to microfinance mission drift and encountering national financial regulators' opting between two approaches: microfinance for the social development target or microfinance for profit. Basing on their highly contextual development with participants of both internal and external concomitant as well as the financial demand of the poor in each country, States decided their own development approaches, framed suitable microfinance institution models, tried to integrate portion of microfinance spectrum into their respective regulated financial sectors. In the last four decades, microfinance has spread across most continents with various models as per local needs including associations, bank guarantees, community banking, cooperatives, credit unions, Grameen bank, group, individual, intermediaries, non-governmental organizations, small business and village banking models. Microfinance in Vietnam, with its distinguishing characteristics such as being rural-based, the involvement of socio-political organizations and State-supported policy lending bank is now in the evolution process of transforming from unregulated into regulated institutions toward a sustainable inclusive finance system. It requires a dynamic innovation and a complete understanding of microfinance evolution to know what should be the suitable conditions for development, what could shape its growth and what factors constraint it. Although it is impossible to build a unique development formula for all microfinance institutions, it makes sense to consider some successful practicing benchmark models in some developing countries in Asia area to shed light on the changing field in Vietnam and identify the conditions that limit the scale and scope of microfinance activities in this country. Keeping that in mind, in this paper we undertake Grameen Bank model in Bangladesh and village banking model of Bank Rakyat in Indonesian (BRI) as case studies to make comparative analysis with the microfinance system in Vietnam in term of financial innovation and methodology. The Grameen Bank and the BRI are chosen for this analysis because these two countries and Vietnam are developing countries in the Asian region that has been called "a cradle of microfinance" by the World Bank with a large potential demand for microfinance in rural areas. Moreover, the two banks are the two greatest successful benchmark representatives for the two microfinance approaches: Grameen Bank is the first leading microfinance bank in the world focusing on developing sustainable microfinance for poverty alleviation; whereas, Bank Rakyat, Indonesia is the world largest sustainable commercial microfinance system, the first evidence of developing microfinance for profit target. The presentation of cases cannot be fully comprehensive. Rather we intend to take selective business approach, focusing on financial innovation and the adaption of microfinance institutions models with institutional environments variance according to the context of host countries, local demands for microfinance services toward safeguarding the sound growth of the microfinance market.

2. Background of microfinance in the three countries

The model of microfinance in Bangladesh as it originated at Grameen Bank is characterized by tiny loans to women with fixed terms and amounts, group liability, weekly meetings and forced payments into a group savings account. The success of Bangladesh microfinance has been seen in experiences of Grameen Bank which has been well-known all over the world. While many in the microfinance industry and outside equate microfinance with Grameen model, the bank quietly kept innovating itself, re-engineering its model to pursue an expanded vision. The introduction of Grameen Bank II in 2002 marked the most dramatic shift, re-tooling the bank's operation thoroughly with new lending methodologies, products and support services. Today with the innovation, there are a lot of departures from the original model in which the biggest change is the relaxation of formal group liability. Group liability has no longer been used to reinforce loan contracts; instead, they use groups to facilitate interactions with clients and may offer various incentives for peer support. Other changes focused on making microfinance more valuable with clients both in terms of better products and a simple business process. Grameen Bank may be the best example of how a sustainable and effective decentralized structure of competent dedicated lenders could have a positive social impact in the country's most impoverished regions. Microfinance has grown to an enormous scale in Bangladesh with approximately 23 million borrowers in the country for roughly 150 million people. These high numbers reflect merits of microfinance in both social and economic contexts of Bangladesh. While Bangladesh develops microfinance linked with social development targets, Indonesia was one of the first countries to develop commercial microfinance in Asia with regulated financial institutions providing the bulk of microfinance services in which Bank Rakyat Indonesia units are dominant actors, receiving two-thirds of savings mobilized in the formal and semi-formal microfinance sector. BRI is the oldest commercial bank in Indonesia, which was stated-owned company until 2003 when it listed 30% of the shares on the Indonesian Stock Exchange (IDX). From a government-owned agricultural development bank, BRI made good use of government seed money and the World Bank loan during an initial phase and could be transformed to be the country's second largest lender by asset and the largest sustainable microfinance network in the world. Its business focuses on providing carefully crafted micro-savings and microcredit products to low-income people at market rates of interest. It also has a comparatively small, but growing, corporate business. With an outreach of 50 million saving accounts and 25 million borrowers through a network of more than 10,000 outlets operating real time online covering both urban and rural areas, the bank can cover its costs from the interest rate margin and finance its expansion from its profit. The bank can create an easy access for their poor clients to their financial services without any credit bias and at the same time mobilize their savings cost-effectively, making an increased volume of loan able fund by exceeded-wide margin between the demand for deposit service and the demand for credit. Their smart incentive financial policies and motivated staffs together with continuously effective innovations in internal management and supervisions helped the BRI Micro-Banking Division weather the Asian financial crisis well and became a unique profitable bank every year since 1986, even during the crisis years of the late 1990s when the country's financial system collapsed.

In comparison with Indonesia and Bangladesh, microfinance sector in Vietnam appeared later thanks to the influence of global micro-finance development. It emerged during a period of national robust economic growth since 2000 and has grown rapidly. Demand for financial services has increased with rising incomes and dropping poverty levels. Vietnam lowered its poverty headcount from 58% of the population in 1993 to 37% in 1998; 29% in 2002; and as low as 24% by 2004, meaning that one third of the population has been lifted out of poverty during this period. However, poverty was different between rural and urban areas, between the two genders, among economic regions, ethnic groups, and groups categorized by their educational levels. Poverty was reduced in a much slower pace in the central region, the poorest in the country and northern mountains and the north central coast while the proportion of ethnic minorities in the overall poor population increased representing an existing huge demand of microfinance in rural areas, especially in remote mountainous areas. Vietnam's current microfinance system, although extensive in most recent years, has been still shallow penetration. The government uses a dual approach that is both market-based and state-driven to ease the financing constraints of poor and rural households. Targeted policy lending with subsidized interest rates remains substantial in the country's microfinance sector through operation of the government's poverty-reduction funds under the Vietnam Bank for Social Policy.

3. Comparative analysis

Microfinance institutions working in a certain country are influenced by not only common economic factors such as country population, income levels and degree of market liberation, but also institutional contexts with factors such as consumer tastes, employee expectations, geographical characteristics, government regulations and local ethical norms. According to the institutional theory literature, institutional environments vary across countries. The concept of institutional distance which was developed in the international business literature stated that cultural, administrative, geographical and economic differences are important factors in shaping the conditions of profitable expansion of business models across national and cultural borders. Under this theory, national institutions play a significant role in establishing, restricting or incentivizing, providing resources and capabilities, defining legitimate and illegitimate behavior for business institutions. Applying this concept as the theoretical perspective in microfinance to look at the role of national institutions in shaping diffusion of global microfinance models, we are showed with the diversification of institutional innovation to adapt with the host country context among countries as well as help explain what types of microfinance models are likely work under what type of institutional conditions; why non-profit models maybe more appropriate than commercial microfinance ventures in some contexts. In the cases of Vietnam, Bangladesh and Indonesia, the different specifics of institutional environments among the three microfinance industries resulted in the difference in the choice of microfinance approach, business model, degree of freedom in regulation and financial innovations.

The first different feature is the microfinance perspectives among the three countries' governments. This difference presented not only distinguished ideologies among States in terms of management policies but also how the countries' institutions influence in shaping different microfinance institution models in the three countries as well as differences in the degree of freedom of microfinance regulation. According to the perspective constructivism and constructivism perspective, State's preferences and the way it shapes its policies, law, rules, norms and institutions point out to its deep-rooted value and belief system. The State is not only political actors but social ones as if it has mind and soul of its own. This is the reason why States choose different paths to development, adopting specific policies in their unique ways shaping their own socio-economic - political - legal context, a distinctive dominant ideology, a special set of cultural values and a governance structure. Microfinance is likely to fall into the rubric of those industries that require strong local adaptation than global standardization. Microfinance institutions can be profitable in some suitable conditions but it is unlikely that any single business model will work with the same success across the entire business environment. Although both Vietnam and Bangladesh follow the approach of microfinance for social development, the ways to control and manage the microfinance industry of the two States are different. In Vietnam, the government uses dual approach: market-driven and state-driven to control and deal with microfinance problems while the State of Bangladesh applies financial deregulation, letting the market drive rather than making State expressive influences on microfinance operation which has some similar features with the ways the Indonesian State does in managing their commercial for-profit microfinance. Thus, it needs a separate set of regulation. Microfinance institutions are not commercial enterprises but social businesses. That point of view led to the establishment and operation of Grameen Bank under special Grameen Bank Ordinance 1983 as a specialized bank to serve the rural poor. It is a private bank with private citizens comprising the majority of its Board Members and its shareholders. The Board of the Bank, not the government, is the competent decision-making body. Grameen Bank is not, therefore, expected to conduct its operations in the same manner as nationalized or other government-owned banks to which their own laws apply. Grameen Bank's Board operates independently, innovates freely, free from regulatory intervention. In Grameen Bank, work is not focused on head office, they apply direct customer approach. Trust is the strong management system. Among microfinance institutions in the world, Grameen bank seems to enjoy the most freedom in regulation, its only limitation is asking for permission from Bangladesh Bank when opening new branches if any. Bangladesh Bank supervises Grameen Bank's operation but do not interfere into its business activities. Supervision is conducted through collection of all kinds of information from Grameen Bank on a regular basis in prescribed formats with a view to closely monitoring the activities of Grameen Bank or on-site inspection visits and recommendations made related to the Bank's management. Until now, there is no law in Bangladesh that limits the rates. However, with the view of microfinance for development target, the Bangladeshi government has fixed the interest rate for government-run microcredit programs at 11% at flat rate. It amounts to 22% at declining basis. Although being not a state-owned bank, Grameen Bank's interest rate is still lower than the government rate with different rates on each loan scheme: 20% (declining basis) for income generating loans, 8% for housing loans, 5% for student loans. The board of the Bank sets the interest rate such that after paying all expenses, including the cost of its growth, the bank makes a modest profit. The profit is returned to the shareholder-borrowers in the form of dividends. Although there are still many controversies in the way the bank computes the credit interest rate, on balance, Grameen bank loan seems to be pretty cheap particularly in the fact that the bank applies 0% (interest-free) loans for Struggling Members (beggars).

In Indonesia, commercial banking has been a long tradition. Different financial providers are converted by different regulators and regulations. This is as much the result of the historical development of these different institutions as it is about differences in products they offer. Bank Rakyat is one of the state-owned traditional commercial banks, under Indonesia's banking laws, it operates under the supervision of the central bank which has the role of maintaining the stability and value of the rupiah, governing the smooth functioning of the payment system and regulating deposit-taking institutions, particularly banks. The appearance of microfinance unit desa network in the Bank Rakyat is indeed as the new form of commercial bank entering the microfinance market. It is considered as the microfinance operating division of the bank. The organizational structure of the BRI is a 4-tier layers in which the village unit division of BRI is in the bottom tier, but the microfinance division of the bank is separated and independent of BRI large commercial banking network. BRI unit desa system has been able to operate autonomously and stayed free from the government's intervention such as credit targeting, interest rate restrictions or any interference in lending decisions. Only commercial credit is to be available at the units. Although the government decided not to stop the credit subsidies at BRI but limited them at branches at the district level in order to take subsidies out of the units and let market forces operated there, all unit desas can enjoy the deregulated interest policies and transferred in to self-dependent profit centers and received the management directly from head office. Leaders of the village-based unit can decide and adjust the interest loan basing on the real market.

While Grameen Bank in Bangladesh follows microfinance for social development and BRI bank, Indonesia applies microfinance for profit approach, Vietnam's microfinance is somewhere between the two. With the dual approach of market - based and state - driven in microfinance management, the Vietnamese government directly participates in providing microfinance services in rural areas. The two largest banks working in the field of microfinance are the Vietnam Bank for Agriculture and Rural Development and the Vietnam Bank for Social Policy (VBSP), which are both state-owned. They are supervised by the State Bank of Vietnam under the Law on Credit Institutions. Most other non-governmental organizations have heavily involvement with mass organizations which are intertwined with the government and are also subject to interventions by local government officials. The interference of the government in microfinance activities is for the purpose of keeping microfinance not going out of the social business target, helping eliminate poverty all over the country. It has advantages of distributing the government's lending programs to poor customers in a lowest bottom of the society, understanding local conditions. Even the BRI, although following the model of profit targeted commercial microfinance, still did not stop their subsidized lending. But, instead of implementing in unit levels, the bank confined it to branch levels in order to maintain financial health and credit discipline. In Vietnam's case, the VBSP is established for the State's objective of serving policy targeted customers, particularly the extreme poor in remote disadvantaged areas, that really need the Government's assistance and out of the outreach of commercial banks due to the low possibility of gaining profits. Currently, their loan schemes include poor households lending, loans for disadvantaged students, job creation, overseas workers lending, credit for safe water supply and rural sanitation, housing-support loans for the poor, loans for poor ethnic minority households in extremely disadvantaged areas. The bank's contributions cannot be denied - it is an effective tool of the Vietnamese government in performing the State credit policy in terms of supporting rapid and sustainable poverty reduction and narrowing the gap between the rich and the poor. However, with the increasing gross loan portfolio of USD 5.5 billion outstanding to approximately 7 million borrowers across the country, together with the lack of clear classification criteria in rating poor for targeted policy clients, the VBSP with subsidized loan fund and preferential interest has raised concerns from economic researchers about risks of uneven field for competition between stakeholders as well as other risks such as possibly high loan defaults and burdening State's Budget.

The participation of local mass organizations could lead to inequality in executing the business operation due to the lack of transparency and the number and quality of procedures or management teams who are lack of knowledge in banking, accounting and microfinance market. For formalized microfinance institutions (MFI), the State Bank of Vietnam has imposed an interest rate ceiling, whereas semi - formal MFIs have to comply with the Civil Code. Accordingly, the negotiated interest rate has been applied since 24 November 2014, but should not exceed 20% per year, excluding those loans stipulated in other laws or regulations. With that regulation, Vietnamese national regulators hope to avoid fraud on the black credit market that often saw heavy rates and brought negative consequences to the society. However, the question is: can the new government's ceiling interest rate help Vietnamese institutions cover all their operation costs, cost of fund, loan loss provisions and earn profit so as to continue and expand their business? According to the Consultative Group to Assist the Poor (CGAP), compared with international standards, microcredit interest rates in Vietnam are lower than the average of 27% per annum globally in the rest of the world while in Vietnam microfinance institutions revenues come mostly from microcredit, with other microfinance products and services being not very popular.

It is not possible to know which microfinance model is the best: Stated-owned ones, private ones, commercial banks, non-government institutions or credit institutions with cooperation with social mass organizations. Indeed, basing on the institutional distance theory, basing on specifics of each nation, one model can work well in one location and the other in another location, and some locations may be so institutionally divergent that microfinance may not work at all, in which the public welfare or grant programs may remain the only viable option. In the cases of Grameen Bank, Bangladesh and Vietnamese microfinance system, it seems that in less developed economies like Vietnam or Bangladesh where there are still few social welfare conditions, high rate of extreme poor or middle poor in population compared with other levels, but high value of community ties and strong social enforcement, States tend to have dual targets: poverty elimination combined with improving the living standard by supporting social welfare services. In that context, non-profit microfinance institutions have conditions to better grow because of the participation of other social partners besides microfinance institutions and their ways of doing microfinance business go in line with States' development views, while commercial microfinance growth should be likely more suitable in the economic contexts where small scale production networks operate in a relatively stable manner under high political economic stability to ensure the conditions of basic survival for its participants. Ault Spcieral so suggested that there should not be convergence on a single model. Non-profit, for-profit, traditional banks, group lending, solidarity group, village banking, etc. can exist or alternate each other to dominate that depends on local needs to expand microfinance's reach and avoid dependence. Regulations and development directions from States still have and remain a significant role to contribute to the foundation of microfinance institutions at initial phase and the choice of States in microfinance approach decides the way they operate in the microfinance market. For the sustainability of the microfinance sector to be integrated into the financial industry of a nation, we need the favorable conditions in regulation from States to support microfinance operations. Although changing regulations from State levels has been a long and complicated process, the relationship between microfinance institutions and States of the host countries are a two-way interaction, microfinance start-up institutions could develop until some certain points where their maturity will react to State regulation, requiring for a necessary change in policies to motivate their growth further.

The difference in microfinance objectives leads to targeted customer area of BRI bank being more flexible in comparison with the other two; however, the bank is limited in traditional banking services and products while the two others contribute to dealing with other social development issues such as gender equality. Grameen Bank as well as the microfinance system in Vietnam, especially the VBSP, focus on poorer and women clients while microfinance village-based system of the state owned commercial BRI considered their clients to be anyone-not only farmers but also the traders, workers, etc. who have potential to save and pay loans. With that way of doing business, BRI's customer base are mainly the middle poor or better off who are not very poor, and always have demands of borrowing to expand their household business. In contrast, microfinance in Vietnam and Bangladesh through Grameen Bank move beyond microcredit to other development services like women empowerment, education, health and hygiene, etc. Particularly in Vietnam, a microfinance institution called "TYM" organized by the Vietnam Women's Union provides Vietnamese women in rural areas with a chance to access financial services, trained to become the boss in their household businesses.

If institutional environments gave momentums to frame and reform various kind of microfinance institutions models through regulations and policies from States' level, the sustainability of microfinance institutions in long term depends mostly on their internal financial innovations such as product and process innovations to be compatible with the local needs. However, in comparison with Grameen Bank and the BRI, Vietnamese microfinance institutions are less flexible particularly in products innovations as well as finding alternative solutions for their financing source troubles. Microfinance institutions in Vietnam mainly offer traditional products such as loans and savings. Among the latter are savings accounts, for a very modest part. Some semi-formal NGO MFIs provide remittance payment and transferring money but it is still limited. Micro insurance products are almost young and not popular among poor clients. Grameen Bank, on the other hand, diversifies their products and services for all demands of their clients: apart from offering microcredit loans as a core product, it also offers micro-saving, micro-insurance and pension funds. Their staffs are always close to the market to find and catch clients' tastes and report to the bank to adjust their products and services on time. In realizing the higher climatic risks faced by the agricultural activities, the bank offers micro-insurance that are welcomed by farmer clients. Micro-insurance not only reduces the burden on the borrowers when a disaster happens but also saves the financial accounts of the Grameen Bank from deficits caused by uncollectible loans. Other microfinance products offered by Grameen Bank are pension funds and scholarships to the outstanding children of the borrowers.

The pension fund is designed to help the poor to build a nest egg for their old age. Among the subsidiary microfinance products offered, the Grameen Bank pension fund savings program is the most successful program in the Grameen Bank. In 2007, total deposits in the pension fund amounted to USD 400 million, which represented 53% of the total deposits in the bank. Not having various kind of products like Grameen Bank, but saving and loan products of BRI bank Indonesia are designed based on research and market surveys on customer's needs. That is the reason why their two main products - Simpedes and Kupedes - are well-known all over the country and become the most attractive banking products. With the saving product Simpedes, the poor can enjoy no fee to open accounts, no minimum balance, no compulsory deposits or withdrawal restrictions and interests are paid monthly on all but the smallest balances (less than 10USD). All Simpedes accounts are linked to Bank's bi-annual lotteries that are held in the bank's branches; winners and local people are located within a small area so they know each other and make the product schemes popular.

The funding source has also been considered a critical requirement in determining the growth and overall health of microfinance organizations. In order to finance their lending and meet other financial and social objectives, microfinance institutions need to find ways to access to funding. While Vietnamese microfinance institutions are still financially dependent, Grameen Bank in Bangladesh and Bank Rakyat, Indonesia are the two big leading self-sustainable microfinance organizations in the world. They overcame the obstacle of funding resource limitation in their own ways. Grameen Bank chose to diversify their banking products and services to earn revenues for their lending funds and cover the costs of their operation. Besides, the bank tried to seek financing in local market by issuing bonds and debentures, increasing saving deposits from member and non-member clients. Instead of disbursing more capital as loan, the bank moved to earn profits by increasing fixed deposit investments in local commercial banks. Grameen Bank can also seek to borrow capital from Bangladesh Palli Karma Sahyak Foundation (PKSF), a wholesale for the expansion of microcredit programs if any. Unlike Grameen Bank, funding resource for loan portfolio in Bank Rakyat, Indonesia comes from public savings. Saving mobilization has been an integral part of the unit banking philosophy and strategy. The bank applied compulsory saving accounts together with other kind of voluntary savings. Realizing that not all borrowers are able to go to the bank regularly because of their family commitments as well as transportation constraints, BRI' staff took the initiative to go to the borrower's house or business premises on a daily or weekly basis to collect their savings. Besides, BRI was among the first microfinance institutions taking part in the capital market. The bank has been listed in the national stock exchange and sold internationally. The success in the stock market brings to the bank the chance to raise their capital to invest in business expansion.

4. Conclusion

What draws this article is the rise in popularity of microfinance services worldwide and the need of Vietnam's microfinance development toward self-dependent sustainability. It is helpful to chalk out similarities and differences in practices and models as well as the socio-economic and political construct in of a society that chooses and adapts them. As previously said, microfinance is not a "one size fit all" solution so it is not easy to apply microfinance models from one land to another. The article emphasizes the role of flexibility and adaptability in microfinance innovations among countries in which the market drive and customer-centredness are key factors that can lead to the success of microfinance operation. The article once more time supports the argument that there is no better than the other: not-profit or for-profit commercial institutions. All type of microfinance institutions can exist or alternate each other to dominate, that depends on local needs, and even in the same countries, several kinds of microfinance institutions can be operated at the same time if they are suitable and adapted with the State's objectives. The important thing is that State law regulators should find the ways to create a favorable and fair playing field for all interested participants. Otherwise, there could be constraints for the development of their own microfinance industry. Besides the significant role of State levels, the article also confirms the decisive role in self-innovation of microfinance institutions through the introduction of new products and services or their financing process for their long-term sustenance. Being adaptable with the institutional environments and continually innovating in conducting business operations as well as the introduction of new products and services as per the local needs are the secrets of success of all leading microfinance organizations in the world.

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