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Improving Bankability Through an Insurance Fund in Local Credit Groups of Northern Vietnam

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Abstract

Access to financial services has proven to be important for poverty reduction of rural farm households in developing countries. The term bankability comprises all characteristics that improve access to financial services and more it can be seen from the perspective of the financial intermediary and from the perspective of the client and civil society. This research found that a large proportion of the population in rural Vietnam refrains from becoming a member in credit groups as they evaluate their bankability as insufficient. One solution jointly developed in guided working groups was to set up an insurance fund in the credit groups. This is an innovative instrument to reduce the clients fear of becoming indebted.

1 Introduction

Well functioning rural finance institutions are an essential requirement for promoting technical, economic and social development leading to better living conditions in rural areas. Access to financial services has been shown to be important for poverty reduction of rural farm households in developing countries. It contributes to higher income and better food security. Former research has demonstrated that participation of the poor in credit and saving networks is also correlated with improved nutritional and educational status of children and lower birth rates among women. Although, more and more private and public agencies get involved in raising the efficiency of financial systems targeting the poorer clientele, the effectiveness to improve access is below expectations (Schrieder, 1999 and CGAP, 1995). A lack of bankability of the target group, not only from the perspective of the financial intermediary but also from the clients point of view appears to be part of the problem. The term bankability comprises all characteristics that improve access to financial services.

1.1 Problem Statement

This research found that a large proportion of the local population refrains from becoming members in credit groups and applying for credit because they value the risk associated with indebtedness higher than the possible return on investments. One reason for this observation is that the range of feasible and profitable investment ideas is limited due to an almost not existent extension service. Another reason is that no insurance system is existing which would reduce personal and/or covariate risks that may occur while being indebted. Therefore, the clients shy away from demanding credit or in other words they evaluate their bankability as insufficient. The objective of this work is to present possible solutions to reduce the risks. One possible solution, namely the establishment of a credit-group-based insurance fund was developed in a participatory research approach with guided working groups in several communities in Northern Vietnam. The research questions are (1) how local people would like to set up an insurance fund and (2) will this innovative credit-insurance-linkage model be accepted and reduce their reluctance of becoming indebted. If successful, this model could raise the bankability of villagers from the clients' point of view.

1.2 The Research Area

The Vietnam Bank for the Poor (VBP) has divided Vietnam into seven agricultural economic zones. Ba Be district is located in zone No. I: "Northern mountainous region and middle land". From the 12 million people living in this zone 29 % are considered as poor and among them 5 % as very poor or hungry (VBP, 1995).

About 95 % of the ~70 000 people in Ba Be district are ethnic minorities. The population density is 1.66 ha total land area/person. The General Statistical Office (1995) specifies the land use with 0.1 ha arable land/inhabitant for the Ba Be district. This is even lower than the nationwide average. The population growth rate in the area is declining from 2.4 % in 1995 to 2.2 % in 1998 (Statistical district office, 1999). Two communes were chosen for the research of this survey. Nam Mau commune with a total population of 2 818 people (in 1999) is located inside the recently created Ba Be National Park. Khang Ninh commune with a total population of 3 293 people (in 1999) is located in the buffer zone of the National Park. Both communes are located in the Ba Be district. Three villages representing two ethnic minorities, the Tay and Dao group have been chosen for the survey.

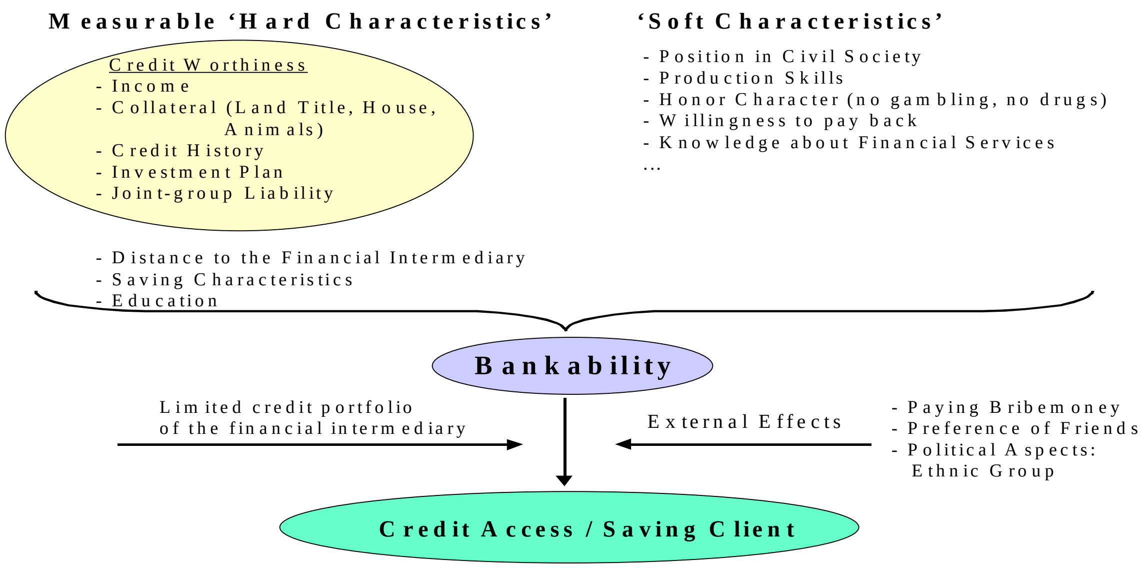
2 Methodology of the Survey

This paper is based on a three months survey in the mountainous Ba Be district of Northern Vietnam in the Bac Kan province. In a farm household survey using a standardized questionnaire, 86 households from three different villages were interviewed. The interviewees were selected as follows. In each village half of the total number of households were interviewed. After a wealth ranking, which was done by the headman of each village, all the 'very poor', 'very rich' and 'rich' households were chosen and half of the 'poor' and 'medium' ones. This stratified sampling procedure allows to better observe whether these factors influence bankability and subsequent access to the formal financial market (for the definition of bankability see below).

The main results of this paper were jointly developed in a participatory research approach with guided local women-credit-groups in two villages because women are responsible for a large part of the household economy. It was important that the leader of the Women Union in the village participated to insure that the developed idea could be later incorporated in already existing organizations in the village. Two of the three villages were chosen, as a certain level of knowledge concerning financial matters was necessary. In the guided group discussions it was emphasized that any ideas would be a result of the villagers and not of the discussion leader. Little is known about the meaning of insurance in general. Therefore this was explained comprehensively. Thereafter, the option of an insurance fund among the members of a credit group was presented and the advantages and disadvantages were explained. In the following a guideline of aspects was discussed and possible solutions were jointly developed.

Although the concept of bankability is not the focus of this paper, the term which is widely used in the microfinance discussion requires clarification. Basically, a person who is creditworthy is not necessarily bankable (Nadler, 1999). Similarly, a person who is bankable does not necessarily gain access to credit. Bankability is more than a sound credit worthiness appraisal, it comprises additional characteristics that may be divided in hard and soft characteristics (see Figure 1). Moreover, the characteristics describing bankability can be considered from the perspective of the supply side i.e. the finance intermediary as well as the perspective of the demand side i.e. the clients.

Figure 1: Concept of Bankability



3 The Formal Financial Market in Ba Be District

In the following, the formal financial intermediaries which exist in the research area of the Ba Be district will be presented briefly. Presently, three financial institutions provide credit, these are (1) the State Treasury (ST), (2) the Vietnam Bank for Agriculture (VBA), and (3) the Vietnam Bank for the Poor (VBP). They have only offices in Ba Be town, the district capital although the district consists of 26 communes and 192 villages. Overall, the bank staff is responsible for the financial needs of 69,692 people (Statistical district office, 1999).

The VBP, established only in 1995 as the poor people's lending arm of VBA, is the major supplier of credit for rural investments of the poor in the research area. It is a state-owned nationwide credit institution. The purpose of this bank is to reduce poverty and not to maximize profit (Hanh, 1999). This bank was implemented to lend money at low subsidized interest rates, directly to poor households (HH). The VBA and the VBP are both represented by the same staff at the district level. The interest rate of the VBP is below the market interest rate. In 1998 it was 0.8 % per month. The minimum loan size of the VBP is 100,000 Vietnam Dong (VND) (8 US$) and the maximum loan size is 2.5 million VND (192 US$). After March 1999, the Government changed this maximum loan size to 3 million VND (231 US$) per HH. (Currency Equivalents, July 1998: US $ 1 = VND 12,990) (World Bank, 1998). The VBP does not mobilize savings. While the VBP is working with credit groups on a joint-liability basis the VBA issues mainly individual loans. In view of the proposed group-based credit insurance fund the operational policies of the VBP is especially important.

The main element of the formal rural financial service system is the VBA. At the national level it accounts for more than 90 % of total credit provided by formal financial institutions to households (CGAP & UNDP, 1996). With a credit amount less than 5 million VND (384 US$), the individual applicant is not required to supply any collateral, but needs a guaranteeing signature of a local authority. In 1998, the interest rate for credit was 1.2 % per month. The only savings scheme available in the research area is offered by the VBA. Interest rates range between 0.3 % to 0.65 % per month according to the savings term (VBA, 1999).

Although the ST is not a financial intermediary in the sense of financial market theory, it is in charge of a special government credit program in Vietnam: 'The Decree 120 for labor and unemployment solutions'. The total available credit fund within this program is divided between the organizations in the district. From 1998-2001 the amount of 60 million VND is assigned to the Women Union of Nam Mau commune. In Pac Ngoi, one of the surveyed villages ¾ of the HH obtained a credit from this program. Only women can participate. The loan size is fixed with 500,000 VND for each HH; interest rate is 0.6 % per month. This rate is even lower than the VBA's and the VBP's rate.

4 Improving Bankability through Credit-Group based Insurance Funds

Bankability and thus access to credit is constrained in rural Northern Vietnam. The degree of this constraint is surprisingly high, nevertheless, the research underlying this paper identified solutions to improve banakbility and thus access to credit.

4.1 Lack of Bankability from the Clients' Perspective

About 56 % of all interviewed HH had access to credit. Out of this group, 92 % of all HH with access to credit were a member of a credit group. One reason for this high percentage is the credit program of the ST that has a strong impact in one of the surveyed villages. If the same calculation is done excluding the isolated ST program the following results are found. A total of 40.7 % of all interviewed HH had access to credit and among them about 71 % are members of a credit group (see Table 1).

Table 1: Distribution of Borrowers according to the Money Resource

No. of HH which are member of a credit group	33		
No. of HH which borrowed individually		4	
No. of HH which are a member of a credit group and borrowed individually			11
% of all interviewed HH	38.2 %	4.6 %	12.8 %

Source: Own data

Intuitively, it appears that the figure of 56% of all HH having access to credit is quite impressive. Nevertheless, this research found that 31 % of all interviewed HH refrain from becoming members in credit groups. Also, a large proportion of the HH, namely 73 % did not try to apply individually for credit at the VBA. Empirical evidence for this is shown in Table 2. In the conceptual framework of this research, these clients evaluate their bankability as insufficient. Analyzing the reasons that determine the leading roles in farmers' decisions to refrain from borrowing is done in this section.

The reasons given for refraining from borrowing money can be split up in two groups of answers as indicated in Table 2. One group of answers indicates that a high proportion of farmers value the risk associated with the investment higher than the possible return. In total these reasons were mentioned 66 times.

The second group of answers is related to an almost non-existent extension service and with this the limited range of feasible and profitable investment ideas and a general lack of information concerning financial services. These reasons were given 32 times. These results confirm field impressions from the study area.

Table 2: Share of HH which refrain from borrowing and Explanations given

	Did not try to borrow individually	*Did not try to join a credit group*
No. of HH	63 HH	27 HH
% of all interviewed HH	73 %	31 %
Reasons for not trying (No. of answers)		
Too risky to invest		
Too poor to apply for a loan	15	4
Not enough assets as security or collateral	5	3
I am afraid that I am not able to pay back the interest	7	5
I am afraid that I am not able to pay back the loan principal	10	7
Interest rate is too high	6	1
Too risky to invest into agriculture	1	2
Lack of knowledge about investments		
Do not know how to invest	6	7
The procedure is too complicated	6	2
Lack of information	8	3
Others		
My relationship to important persons, like cr. gr. leader, village headman or commune leaders is not good enough	2	2
No need for borrowing, enough private money	4	4
No need for borrowing, access to individual loan		1
Not able to read and write	1	

Note: one HH can fit into more than one optional path. Note: it was possible to mention more than one reason.

Source: Own data

4.2 Improving Bankability

As mentioned above rural people often evaluate their bankability as insufficient. Possible solutions could be associated with risk reducing mechanisms and with improved information. The first point will be discussed in the following. It was argued that the risk to invest is too high and that they feel like not being able to pay back loan principal and interest in case of unexpectedly occurring personal and covariate risks.

Formal insurance schemes are rarely found in developing countries. They are practically non-existent in rural areas (Alderman and Paxson, 1992). In the case of the study area there was none. Evidence from microfinance institutions around the world indicates that, beyond credit and savings products, clients have an unserved need for products to insure against many of the risks to which they are exposed. The lack of an available services to protect against these risks could have a negative impact on the livelihood of clients and affect the financial health of the finance intermediary itself (MBP Newsletter, 1999).

In both villages, a credit amount of 500,000 VND (38 US$) that is frequently granted by the VBP and the ST to credit groups was used as an example. It was proposed to transfer part of this loan to a common insurance fund. In the following, a summary of the most important discussion points is given. The ideas developed in the two compared villages as it concerns the introduction of an insurance fund are illustrated in Table 3.

Table 3: Discussion Points for Setting Up an Insurance Fund

Suggestions and Questions from the Discussion Leader	**Answers of the Pac Ngoi Group**	**Answers of the Ban Nan Group**
1) Example: cr. gr. 1 year, 10 members, each member got 500 000 VND. After paying the interest of 0.6 % they keep 464 000 VND. (for Ban Nan same example with 0.8 % interest) How much are they able and willing to pay each month for the insurance fund?	2 000 VND/ month. It should be less than interest payments.	2 000 VND/ month.
2) What should be done with the money from the insurance pot during the year? It was pointed out that it has to be available in case a member needs the money. Possibilities like leader of the cr. gr. should keep it, or bring it to a bank were suggested.	The participants decided that some members can borrow it for a non-risky investment.	**The solution was to lend it to a member of the group.** -savings at a bank brings too low interest, -lend it outside the group is too risky,- group pressure insures that she pays back immediately if the money is needed.
3) Example: All the members bought pigs from their credit. What is the amount that a member should get in case her 50 kg pig dies? Suggested were: money for a new piglet, or the value of the lost 50 kg pig.	The insurance should only cover the money for a new piglet.	The insurance should only cover the money for a new piglet. -they have to think of other members.
4) What should be covered by the insurance? Suggested was: only pig insurance, as they all invested in pig production in the past and as this would be easier to set up and to control.	They came to the conclusion that the insurance should cover all external effects, which can not be influenced by the members and lead to insolvency. -They do not want to invest all in the same kind of pro- duction in the future. The members should be able to choose between animal hus- bandry and crop production	The group will decide in which cases a member gets money. If everybody wants to invest in something else the insurance should cover all investments. But the group decides each time if it is an insurance case. -They agreed on that

	according to their skills -Example: a member gets sick and must sell the pig to pay the hospital. Thereafter she wants to raise a new pig. If she has no other assets the insurance fund should provide money for a new piglet.	they have to set up clear rules at the beginning.
5) How do they want to control fraud? Example: insurance only for pig production. How do they want to control which pig is from the credit? Ear-tag? If they want to open the insurance to all kinds of risks, controlling gets even more complicated?	The problem of fraud does not exist. They all know each other. They know exactly which pig is bought from the credit. They want to define clearly at the beginning what is covered by the insurance.	No need to mark the pig because they want to help in general way if somebody is not able to pay back the loan.
6) Do they want to set up rules how to keep and raise for example the pigs? Pointed out that vaccination and stable keeping reduces the risk of pig diseases. If they all pay the same amount to the insurance pot they all have to care for the pigs in the same manner.	**They want to set up rules for vaccination and stable keeping.** If the group members agree on the vaccination a member who did not vaccinate will not get any insurance money.	**Good idea to set up regulations, controlled by the group** If the members agree on the vaccination a member who did not vaccinate will not get any insurance money.
7) What about if they can also invest in crops? It will be much more difficult to control which plants are from the credit. Example: buy seeds for 500 000 VND from credit and fertilizer for 1 Mill. VND from own money. Later the crops are damaged, what should be covered?	According to the percentage they want to cover a part. They understand the idea and the problem. They want to set up rules at the beginning which have to be clear to everybody.	Risks in crop production should be also covered, as they want to insure all risks that contribute to insolvency of a member.
8) Do they want to elect a leader who is in charge of the insurance?	**Yes.** “Leaders pocket is saver than common pocket.”	**Yes.** Vote a leader who is knowledgeable.
9) Will this insurance fund make it easier for them to borrow money?	In case of risks they can get some help. They feel less afraid to borrow.	If they would have known this before they would not have been so afraid. Feel better with the insurance.

5 Conclusion

In section 2, the term bankability was discussed and described as a term which often comprises more characteristics than just the pure credit worthiness as a necessary precondition to gain access to financial services, particularly credit. The empirical results in this paper show that a lack of bankability from the perspective of the clients exists. A high proportion of possible clients evaluate their bankability as insufficient and refrain from borrowing although they would need additional liquidity. They value the risk associated with the investment higher than the possible return. One solution jointly developed in two guided working groups was to established an insurance fund in credit groups.

In both villages the concept of insurance was totally unknown. In both groups the reaction was very positive with a lively discussion. One group noted the discussion and their solutions in their Village Women Union-activity-book. The thought of self-help fits very well in the socialist determined socio-cultural environment of the local people. It is astonishing that in both groups and independently from each other, almost the same results were achieved. Ideas were developed similarly. The use of the insurance fund should be handled in a more flexible way. Both groups wanted to insure all external effects that lead to insolvency of the members instead of an “object insurance” that would insure only the pig itself. Nevertheless it is obvious that with this kind of insurance fund no supra-regional catastrophes like flood or drought can be insured. The problem of insurance fraud and supervision, the main tasks of insurance companies in developed countries, were not seen as a major problem, as social control inside the group is sufficient to deal with those problems. The leader of the Communes Women Union was informed about the results of this group discussion and she confirmed that the provided ideas are helpful. The incorporation of existing local organizations into this discussion is absolutely necessary to insure the sustainability of the idea. Later on such organizations can spread and implement this idea easier than individual persons. It can not be expected that the insurance fund will be implemented directly. The idea has to settle down in the heads of the people and can be discussed again on occasion. From the members` point of view the idea of creating an insurance fund let them feel less afraid of borrowing money. Thus it can be one solution of improving bankability from clients’ point of view.

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