FROM THE AMERICAN PEOPLE

VNCI Policy Paper # 8

PROVINCIAL POLICY LENDING TO SMALL AND MEDIUM SIZED ENTERPRISES IN VIETNAM

July 2006

This publication was produced for review by the United States Agency for International Development (USAID). It was prepared by Nguyen Thi Canh, Tran Viet Hoang, Hoang Tho Phu and Cung Tran Viet of the Faculty of Economics of the Vietnam National University – Ho Chi Minh City, and Nick Freeman and David Ray of VNCI.

Vietnam Competitiveness Initiative

Dự án Nâng cao Năng lực Cạnh tranh Việt Nam (VNCI) là dự án phát triển kinh tế do Cơ quan Phát triển Quốc tế Hoa Kỳ (USAID) tài trợ nhằm nâng cao năng lực cạnh tranh cho các doanh nghiệp nhỏ và vừa (DNNVV) ở Việt Nam. Dự án có ba cấu phần: (1) Cải thiện môi trường chính sách cho các DNNVV; (2) Nâng cao năng lực cho các DNNVV; và (3) Tiếp cận nguồn vốn cho các DNNVV. Dự án do Công ty Development Alternatives, Inc. (DAI) điều hành, Quỹ Châu Á là nhà thầu phụ chính của DAI thực hiện cấu phần 1 của dự án.

Số 2, Tầng 15, Tòa nhà Prime Centre
53 Quang Trung, Hà Nội, Việt Nam
Tel : (84-4) 943-8163
Fax: (84-4) 943-8160

www.vnci.org

Để xem báo cáo này và các báo cáo nghiên cứu chính sách khác của Dự án VNCI và đọc các tin, bài về hoạt động nghiên cứu chính sách của dự án, xin vào trang **www.vnci.org**

PROVINCIAL POLICY LENDING TO SMALL AND MEDIUM SIZED ENTERPRISES IN VIETNAM

ACKNOWLEDGEMENTS

This report stems from a collaborative research endeavour, conducted in 2005, by Professor Nguyen Thi Canh and her colleagues at the Faculty of Economics at the Vietnam National University - Ho Chi Minh City, and the Vietnam Competitiveness Initiative (VNCI).

A number of individuals worked on various elements of this report, as well as the empirical research work that lies behind it. The principal authors wish to acknowledge and thank the following individuals for their assistance in helping to conceptualise the study, conduct the survey, process the data, and/or conduct the translation work: Luong Thi Thu Ha; Cao Thi Huong Giang; Do Thi Lan Huong; a group of students from 4th class (2nd intake) in finance and banking, in the Economics Faculty at the Vietnam National University; Professor Vo Thanh Thu and her colleagues from Binh Duong University, and Mr Nguyen Hoang Thanh of Tien Giang Department of Planning & Investment (DPI). We also wish to thank Professor Nguyen Van Luan, Dean of the Economics Faculty at the Vietnam National University – Ho Chi Minh City for his kind support.

The report's authors also wish to thank those officers in the relevant branches of DAF and the three provincial assistance funds that very kindly took time to respond to our queries. The authors also wish to thank those officers in the relevant DPI offices that helped identify the companies we surveyed. Last but not least, we wish to express our sincere gratitude to the managers of all the firms surveyed for so patiently answering our questions. Without their illuminating answers, this report would not have been possible.

All remaining errors and omissions, and interpretations and opinions expressed in this paper, are the sole responsibility of VNCI.

*

* *

The Vietnam Competitiveness Initiative (VNCI) is an economic growth project funded by the United States Agency for International Development (USAID). VNCI is managed by Development Alternatives Inc (DAI).

The Asia Foundation is the principal subcontractor to DAI and is responsible for implementing the research and policy component of the VNCI project. The objective of this component is to improve the regulatory environment for business, with a particular focus on regulations governing small and medium sized private businesses. This is the eighth in a series of published policy studies produced by The Asia Foundation under VNCI.

The Asia Foundation

DAI

CONTENTS

LIST OF TABLES

LIST OF FIGURES

ABBREVIATIONS

BOT	Build, operate, transfer project
CGS	Credit guarantee scheme or system
DAF	Development Assistance Fund
DPI	Department of Planning & Investment
HCM	Ho Chi Minh (City)
HIFU	Ho Chi Minh City Investment Fund for Urban Development
MoF	Ministry of Finance
MPI	Ministry of Planning & Investment
NPL	Non-performing loan
PAF	Provincial assistance fund
SBV	State Bank of Vietnam
SME	Small or medium sized enterprise
SOCB	State-owned commercial bank
SOE	State-owned enterprise
VDB	Vietnam Development Bank
VND	Vietnam dong currency

EXECUTIVE SUMMARY

A lack of adequate access to financing is widely regarded as one of the major constraints on enterprise (and particularly SME) development, in virtually all countries, both developed and developing. A diverse spectrum of factors can cumulatively serve to inhibit both: i) the ability of firms to tap financial resources that can help them burgeon; and ii) the ability of banks and finance firms to provide such funding resources.

In seeking to identify and surmount these inhibitors, recent years have seen emphasis shift away from the direct provision (usually by government agencies) of subsidized financial products and services to individual firms, and shift towards policy interventions that create the kind of conducive enabling environment that allows pro-business financial products and services to organically develop in the financial marketplace. Rather than substituting for a defective financial market, the aim is to remove the underlying defects, so that the market can operate efficiently and effectively.

Put another way, current best practice in business – and particularly SME – financing places greatest emphasis on market strengthening. Such initiatives tend to be: i) more sustainable in the long-run; ii) entail fewer distorting side-effects; and iii) incur fewer costs for the government, and the economy as a whole.

As a consequence, policy focus has shifted towards removing regulatory and non-regulatory obstacles that prevent or constrain the banking and financial marketplace from providing companies with better access to funding. This is often where the greatest benefits can be derived, and also tend to be more effective in the long-term, as the approach entails trying to cure the underlying problem, rather than offering a more short-term (and potentially costly) palliative for the symptoms.

If government agencies do seek to introduce new financial products and services tailored to meet the needs of the corporate sector, ideally their role should primarily be a catalytic one; supporting their introduction and initial development. Government agencies should generally not, however, seek to become directly involved as financiers or bankers to the business sector, whenever possible. International past experience suggests that rarely do government agencies and officers make good bankers or financiers, as this is not their core competence. Rather, their core competence is designing and enforcing a regulatory environment that is conducive to business.

It is also important that the kinds of interventions that a government pursues, whether at the national or local level, does not have an adverse impact on the viability of commercial banks and other financial institutions. For example, for government agencies to be providing loans at interest rate levels that are lower than those offered by commercial banks, particularly to firms that can readily get conventional bank loans, is, at best, duplicating what the market is already doing. And at worst, it is undermining the development of the banking sector, at a real cost to the State (in the terms of interest earnings foregone).

It is important to note that, at the time of writing, it is not a basic lack of money (or financial institutions and agencies) in Vietnam's economy that is serving to constrain corporate and SME funding per se. Indeed, one might argue that Vietnam currently enjoys comparatively high levels of financial liquidity. Rather, there is a need to improve the quantity and quality of funding products and services provided to the business sector, through various regulatory and non-regulatory initiatives, on both the supply side (ie. banks and finance firms) and the demand side (ie. companies).

There is relatively little information in the public domain pertaining to the providers of subsidised loans in Vietnam. Gaining access and information to these agencies is not always easy, and at the commencement of this study it was not clear how much insight we would be able to derive. It was therefore decided to take an exploratory approach, seeking to build up a basic profile of the three Development Assistance Fund (DAF) branches and three Provincial Assistance Funds (PAFs) operating in three southern locations: HCM City, Binh Duong, and Tien Giang. This provided us with two simple case studies, comprising: i) the broadly similar DAF branches in the three locations; and ii) the more divergent PAFs operating in each of these same three locations.

To complement the exploratory case study approach taken towards the providers of subsidised loans, it was decided to conduct a more conventional, quantitative study of real and potential recipients of such loans, through the use of a company survey. A sample comprising 230 firms, from both the state-owned and private sectors, was compiled across the three locations. More specifically, 170 companies from HCM City, 40 from Binh Duong, and 20 located in Tien Giang were selected and surveyed. The sample comprised two equal parts: i) 115 firms receiving subsidised loans; and ii) 115 firms not receiving subsidised loans.

A number of interesting findings come out of this study. In general, SOEs and equitized former SOEs tend to have better access to subsidized loans than their private sector peers. On average, those firms receiving subsidized loans had operating capital that was more than 3.5 times larger than similarly eligible firms without such loans, which suggests that larger firms also have better access to such loans. Put another way, private sector SMEs appear to find it difficult to access policy loans.

DAF's loan products (and the kinds of conditions attached to these loans) are generally similar to those offered by commercial banks: the principal distinction being that DAF's interest rates are markedly lower than that of the market average, and its collateral requirements are sometimes less stringent than those of commercial banks. The provision of loans by DAF is also quite widely dispersed, so that some companies are simultaneously borrowing from both commercial banks (at market interest rates) and DAF (at subsidized interest rates).

At present, all PAFs are mostly focused on lending activity, and like DAF, usually offering loans with interest rates that are lower than those of commercial banks. The risk management procedures at PAFs appears to be fairly relaxed, with the reserve for bad debt derived from after-tax income, rather than – more sensibly and conventionally – being based on some measure of outstanding loans (as stipulated in banking regulations for commercial banks).

Our company survey results showed that almost 60% of firms currently not receiving subsidised loans were unsure of their eligibility status for such financial support. This clearly shows that the current policy is not sufficiently understood by many Vietnamese firms. This is perhaps not surprising when one looks at how little information exists in the public domain about DAF and the various PAFs. Despite being one of the largest financial institutions in Vietnam, DAF does not even have a simple website that provides a modicum of information.

Our survey suggests that the three main factors motivating firms to seek a loan from the local PAF or DAF branch – rather than from (or in addition to) normal commercial banks – were: i) lower interest rates, cited by 79% of our sample of firms receiving such loans; ii) lower collateral requirements, cited by just over 24%; and iii) more attractive loan terms and conditions, cited by roughly 6%.

Our survey found that less than one in seven projects that received preferential credit operated within the list of priority sectors and locations cited in Decree 106. Indeed, the majority of projects that received preferential credit were operating in other areas of business, and subsidised loans were mostly used to either finance production expansion or to finance exports. The majority of recipients belong to List A of the Law on Domestic Investment Promotion, with a significant proportion of their output being exports.

Across our sub-sample of firms that received policy loans, we estimate that the government had to pay a net cost, over the actual benefits derived by these firms, of VND 69.76 bn. It could be argued that such policy loans create demand for investments, and thus benefit the wider economy. However, our survey of firms receiving policy loans revealed that nearly 60% of these firms could obtain a similar loan from commercial banks. And as noted above, the main reason why they borrowed from DAF or a PAF was simply because the interest rate was lower.

From this, we can make a rough estimate of the net cost to the State, over the actual benefits derived by firms receiving subsidised loans in Vietnam. According to a DAF report, as of end-September 2005, the total value of subsidies amounted to VND 96,960 bn. If we extrapolate from our survey results for 115 companies, it would suggest that the State incurred a net cost, over the actual benefits derived by recipient firms, of VND 2,502 bn.

We also surveyed company perceptions about subsidised lending activity by DAF and the PAFs. More than half of firms currently borrowing from the local PAF and just under half from the respective DAF branch agreed with the assertion that subsidised loans are only for companies or projects supported by the government. In addition, 44% of PAF borrowers and 39% of DAF borrowers agreed with the comment that it is quite difficult to get a loan from DAF/PAF, so most firms do not bother applying. A similar proportion of companies (41% of PAF borrowers and 38% of DAF borrowers) agreed with the statement that getting a normal loan from a commercial bank is much less bureaucratic).

As for those firms not receiving credit from either a PAF or DAF branch, their responses are perhaps more candid in nature. Here, almost two-thirds agreed that it is quite difficult to get a loan from DAF/PAF, so most firms do not bother applying. More than half agreed that it is not clear which companies are eligible for the DAF/PAF loans, and which are not eligible. The comment that subsidized credit is only given to those projects which are supported by the government was met with 45% agreement.

Since this survey was conducted, there have been a number of announcements relating to DAF and some of the PAFs. Most notably perhaps, DAF is expected to become more independent, and is to be renamed the Vietnam Development Bank (VDB). Such developments provide an opportunity to re-assess the policies and practices of state-owned financial agencies, such as DAF/VDB and the various PAFs. The results from this study would suggest that such a reassessment would be timely, for a number of reasons.

First, the activities of DAF/VDB and the PAFs may pose problems with regard to Vietnam's WTO accession negotiations and post-accession membership. Secondly, the costs incurred by the State in providing such subsidised credit, if only in terms of interest revenue foregone, may be greater than the benefits derived for Vietnam's corporate sector. Thirdly, some of the practices of the PAFs, in areas such as risk management, appear to deviate away from international lending practice, and may be insufficient for the development of robust and sustainable financial institutions. Fourthly, partly as a result of these more relaxed operating procedures, as well as access to cheaper sources of funding, state-owned financial institutions appear to have an unfair advantage over commercial banks. And the subsidised credit provided by DAF/VDB and the PAFs is inadvertently serving to undermine the development of the commercial banking sector.

For these reasons, our survey results would suggest that Vietnam should consider re-orientating the operations, products and services of DAF/VDB and the PAFs more towards the kinds of interventions that will: i) not undermine the commercial banking sector, but support it in the provision of credit to eligible borrowers; ii) result in benefits to the economy that exceed the costs to the State; iii) be not actionable under WTO regulations; and iv) allow for the development of robust and sustainable financial agencies. The latter would probably necessitate VDB, and ideally the PAFs too, coming under broadly the same kind of regulatory oversight as commercial banks.

The study concludes by offering some specific policy-oriented recommendations for consideration. First, that the PAFs should consider disengaging from direct lending activity to firms and projects, particularly where this undermines the commercial banking sector in that locale, by undercutting banks on the interest rate offered. If the PAFs are to continue direct lending, it is recommended that they seek to do so at (or closer to) market rates, and focus on firms that are not able to gain access to conventional commercial bank loans, so as to be complementary – and not 'duplicatory' – in the provision of loans. This could be done by introducing financial products and services not already provided much (if at all) by commercial banks and other financial institutions, ideally working in conjunction with commercial banks, rather than as competitors.

If PAFs still feel the need to provide loans to eligible companies, to support specific projects that have positive socio-economic impact, it is recommended that this be disbursed, wherever possible, through appropriate commercial banks, using instruments such as revolving credit lines. This has the benefit of both harnessing the expertise of commercial banks, as well as limiting the costs of maintaining parallel institutions to a minimum, thereby optimising the amount of money that can actually be directed towards worthy projects.

We also recommend that there should be checks in place to ensure that PAFs are not obliged to pursue loan or investment projects that could imperil their capital base and long-term sustainability. As the majority of funding for PAFs still comes from the provincial budget, this puts some pressure on them to comply with the wishes of the relevant People's Committee, further reinforced by the fact that senior appointments at the PAF are made by the People's Committee.

At present, different PAFs operate according to differing regulations that are issued at the provincial level. While this may give some flexibility for each PAF to tailor itself better to meet the specific needs of its host province, one cannot expect every province to have the capacity to devise a robust regulatory structure to govern the activities of its PAF, and the prospect of every province undertaking the same exercise would suggest a large duplication of effort. Therefore, if the PAF concept is expanded to more provinces, we recommend the drafting of some standard regulatory guidelines, ideally by a body that would also then seek to ensure that such guidelines are enacted in practice. Some form of regulatory oversight, at the national level, might be appropriate, particularly if PAFs wish to raise funding through the issuance of bonds, or some other kind of debt paper.

Turning to DAF/VDB, we recommend that it should seek to avoid competing directly with commercial banks in the provision of loans, given that its privileged access to cheap and substantial sources of funding. A number of strategies could be adopted to prevent this kind of direct competition. One strategy would be to seek, wherever possible, to conduct such lending through the commercial banking sector itself, with DAF/VDB simply providing credit lines to eligible banks for on-lending to eligible projects and firms, and overseeing the process. For example, a revolving credit line into a small number of commercial banks, to support them in the provision of export credit finance to corporate clients that meet a clear set of eligibility criteria.

Another strategy would be to tighten the current eligibility requirements for company recipients of DAF/VDB funding assistance, to limit the risk of undercutting commercial banks to just a few select areas, and focusing on firms and business sectors that find it difficult to harness normal bank loans. A third strategy would be for DAF to look at introducing new financial services or instruments that fill a current gap in commercial banking and finance, and even help support commercial banks in their financial intermediation role. One such service might be the establishment of a sustainable credit guarantee system (CGS) for SMEs and other borrowers, with DAF/VDB playing a central role. The attraction would be that it would take DAF away from directly lending to firms (thereby putting it in competition with commercial banks), and instead become a supportive agent and promoter of conventional bank financing to eligible borrowers that are currently denied access to loans. For example, a CGS that would allow commercial banks to provide loans of longer tenors, so as to support major investment projects that will have a longer payback period.

Finally, we were struck that, although DAF is a direct lender at present, there is relatively little information or promotional literature available on its services. For such a large financial institution not to have even a basic website seems rather odd in this day and age, and tends to add to the general sense of opacity that surrounds DAF. We would therefore recommend that DAF/VDB seeks to improve the flow of information to the corporate community on its activities, through a website and other forms of media. If the costs for the individual PAFs of doing something similar, there may be some utility in collaborating on a central website that provides information on all PAFs currently operating in Vietnam.

INTRODUCTION: RATIONALE AND PRINCIPAL OBJECTIVES OF THIS STUDY

The origins of this report stem from another study, conducted a year earlier, on a tangential topic. Looking at the issues of investment incentives provided to domestic companies in Vietnam, the research team noticed that some companies appeared willing to incur not inconsiderable costs in order to receive a certificate from their local DPI office, giving them eligibility for tax breaks, notwithstanding the fact that it was not always easy to 'translate' these certificates of eligibility into real fiscal benefits, in practice. One hypothesis that the research team had to explain this behaviour by firms was that the investment incentive certificates had additional benefits, other than the tax break itself. And that one of these benefits was that the same certificate also gave the company eligibility to request for subsidised credit (or loans) from a small group of government-owned financial institutions. If this is indeed the case, it would be understandable if firms chose to expend some money in order to acquire an investment incentive certificate, if the costs of doing so could be more than offset by the receipt of credit at preferential terms.

It was from this 'point of entry' that we decided to take a closer look at the provision of subsidised and/or privileged lending to companies in Vietnam, as conducted by government-owned and managed financial agencies. For ease of description, we have termed this activity as 'policy lending'. Until relatively recently, policy lending activity was relatively commonplace in Vietnam. In particular, state-owned commercial banks (SOCBs) were often instructed by the government to provide loans to specific state-owned enterprises (SOEs), to fund specific investment projects. However, the growing realisation that such activity was burdening them with excessive bad debt, and thereby undermining the viability of the banks to perform their role as the leading financial intermediaries in a market-oriented economy, has resulted in the SOCBs being released from policy lending activities. In this context, it is widely thought that policy lending in Vietnam has ceased.

This broad belief is not wholly true. Most countries pursue some form of policy lending activity, in order to provide financial support for specific projects that are in the national interest, most notably in cases where the financial market itself is unwilling, for whatever reason, to do so. Major infrastructure projects are perhaps the most common example, where the pay-back period is often deemed too long or the risks of default are thought to be too high, in the eyes of private financiers. Slightly more controversially, state agencies may also provide beneficial financial support to companies working in sectors deemed strategically important or of high economic potential. The critical issue here is to ensure that such interventions occur in a way that do not inadvertently undermine the financial sector (for example, undercutting commercial banks on interest rates), nor lead to a misallocation of finite financial resources to projects or sectors that is of detriment to the wider economy. Not an easy task.

In Vietnam, the principal policy lending institution is the Development Assistance Fund (DAF). Some reports suggest that DAF is the first or second largest financial institution in Vietnam, in terms of asset size, although a paucity of publicly available information on DAF makes this hard to confirm. In recent years DAF has been joined by about a dozen provincial-level assistance funds (PAFs) of a broadly similar nature. One of the most active and well-established PAFs is HIFU: the Ho Chi Minh City Investment Fund for Urban Development. HIFU's outstanding loans, as at end-2004, were reported to be almost VND 2.6 trillion (around US$165m), across 210 projects, with state-owned enterprises accounting for more than 90% of total loans. HIFU has since been joined by about a dozen other PAFs in various parts of the country, and we understand that there is some consideration of expanding this model to numerous other provinces in the coming years.

Despite their not inconsiderable size, relatively little is known about DAF and the community of PAFs, and so the first objective of this study was to try and get at least a rough picture of what these institutions do, and how they go about doing it. Beyond this, the study sought to assess the extent to which these policy lending organizations are operating in an optimal manner, congruent with international best practice, and thereby playing a positive role in the development of a competitive corporate sector and sustainable economic growth.

It is envisaged that the study findings will be of direct policy pertinence, both in suggesting ways of improving the corporate sector's access to this source of funding, and improving the (currently limited) array of financial products and services provided by Vietnam's lending institutions to their clients. The findings may also be of relevance to Vietnam's joint stock and state-owned commercial banks, in: i) identifying whether the activities of the policy lending bodies are potentially undermining the commercial banking sector, through their privileged access to funds and their provision of subsidized loans; and ii) whether the commercial banks, as professional lenders, could provide risk assessment and other supporting services to these assistance funds, and thereby avoid the duplication of fixed costs stemming from operating large, parallel lending institutions.

It was decided that the overall study should comprise of two components. The first component entailed a detailed empirical study of a select sample of provincial/municipal assistance funds and DAF branches, to better understand: i) their principal sources of funding; ii) their lending principles and practices; iii) the kinds of financial products and services they provide to eligible companies; iv) how they differentiate themselves from commercial banking services (other than providing loans at below market rates of interest); v) the extent to which they may be inadvertently distorting or constraining the development of the commercial banking sector, and deviate away from international best practice; and vi) their portfolio/client profile. This first component consisted of four case studies: the PAFs in Binh Duong, Tien Giang, and Ho Chi Minh City, and the DAF branch activities in these same three locations.

The second component of the study entailed a company survey, to get the corporate sector's view on the loan products and other financial services provided by DAF and the PAFs. Using this survey, we sought to identify ways in which the interface between i) DAF and provincial/municipal assistance funds, and ii) the corporate sector, could be improved. Again, the company survey was restricted to firms operating in Ho Chi Minh City, Binh Duong province, and Tien Giang province. Please refer to the methodology section for more details on the approach taken.

BACKGROUND: SME FINANCE IN THE DEVELOPMENT CONTEXT

Current Thinking and Literature on SME Finance

The development of a business is dependent on a broad range of determinant factors; both internal factors within the firm itself, and external factors from the business environment in which it operates. One important - but certainly not the only - determining factor is access to capital, necessary to fund: i) a firm's day-to-day operations (or working capital); and ii) its more long-term investment (or fixed capital) needs.

This is, of course, true of the smallest SME and the largest multinational enterprise. However, it is commonly found that SMEs have a harder time finding access to formal sources of capital than larger and more well-established firms, for a host of reasons (see section below). As a consequence, they often rely on more informal sources of funding, such as 'loans' from family, friends or customers, rather than banks and other institutional purveyors of financial products and services. If SMEs can access more formal sources of funding, typically the amounts of money involved are relatively small, and the duration (or tenor) of the loan is short. This in turn can limit an SME's growth trajectory. No company can meet its true potential without having adequate access to the necessary inputs; and financing is one of the critical inputs.

Governments and donors alike have increasingly come to realize that the SME sector is a highly important element of a country's national economy and corporate community. Even countries like Singapore and South Korea, which had traditionally focused much of their energy on developing large corporate entities (the GLCs and 'chaebol', respectively), have made a distinct policy shift towards greater SME promotion in recent years. It is increasingly recognized that the SME sector tends to be the main source of employment in an economy, and besides, some of today's SMEs will grow to become the large corporate entities of tomorrow. In simple terms of aggregate company incorporations, SMEs tend to make up the vast majority (95% or more) of businesses in virtually all countries, even if they do not account for such a high proportion of total corporate assets. This realization has prompted policy-makers to place increasing emphasis on supporting the SME sector through various policy and regulatory interventions, as well as more applied (non-regulatory) instruments. And this includes finance-related support.

As the cumulative experience in such pro-SME interventions and instruments has grown, it has been possible to better identify what works and what does not work. And do to discern what are the most, and the least, effective and sustainable initiatives to pursue. This is true for SME sector development interventions in general, and also for SME finance initiatives in particular. Experience has shown that the provision of subsidized financial products (such as lower interest loans for SMEs) and services (such as blanket loan guarantees), especially those provided directly by government agencies, can have a number of drawbacks. One underlying drawback is that any subsidy has a concomitant cost attached to it, even if it may not be immediately apparent, if only in terms of the costs of implementation. Over time, it can be hard for a developing country to carry that cost, thereby rendering the subsidy untenable in the long-run. And if SMEs become dependent on such inherently unsustainable sources of subsidized funding, they may not survive after that source of funding is ultimately switched off. But even if the cost can be endured over time, it may not create much real benefit for SMEs, and/or be less effective that allocating the same cost to a different (and more pro-market) form of intervention.

A second drawback is that direct subsidies can cause unfortunate side-effects that, at best, duplicate what existing SME finance providers are already doing, and at worst, actually undermine SME finance providers. If a government agency is providing loans at below-market interest rates, for example, then this can take customers away from commercial banks that are attempting to gain expertise in SME financing. If the long-term aim is to have a robust commercial banking sector that can service the needs of SMEs, without the need for direct government intervention, then such an initiative is actually counter-productive, as it inadvertently serves to undermine the long-run development of the banking and finance sector. Further, if commercial banks see that the government is active in lending to the SME sector, they may well make a subconscious or conscious strategic decision not to devise and pursue SME-oriented products and services, believing this to be the preserve of state agencies. It also thwarts the development of relations between SMEs and banks that should, over time, create the kind of credit history and trust that fosters greater financing activity.

A third drawback of policy loans to business is a potential deterioration in the repayment culture. Firms may perceive that there is less urgency to repay loans when they are provided by government agencies. This further reduces the incentives for banks and non-bank financial intermediaries to develop the SME sector as a profitable market. The problem is particularly damaging when the community is already accustomed to commercial based lending, but after the introduction of poorly implemented policy loans program, even if just a one-off event, leads to a situation where lenders are expecting more subsidized non-repayment opportunities. This may give rise to the so-called 'moral hazard' problem, where firms and banks alike are prepared to take on more risk than usual, as they are effectively insulated from the consequences of those decisions (ie. they feel that full re-payment of loans are not required).

A fourth drawback is the potential for a direct subsidy-based intervention to be implemented poorly, or operated in a manner that is flawed. Government agencies and their officers rarely have the skills or experience to take on the role of financiers or loan officers, putting them at a distinct disadvantage to conventional commercial banks and finance firms. It can also put them in an uncomfortable position, not knowing what their principal objectives are, and whether they are supposed to perform as bankers or state officials. A direct intervention can typically entail the establishment of new government or quasi-government agencies, which can be costly, with operating costs that are higher than banks, relative to the size of new SME-oriented financing that is actually created. There is also the potential for state-directed 'policy lending' to be deliberately or accidentally re-introduced through such institutions, with the government making arbitrary decisions as to which applicants (ie. which firms) will be granted financial support, and which will not. Such a position of authority also increases the potential for rent seeking activities.

As a consequence of these (and other) kinds of drawbacks, SME finance practices have shifted towards creating the kind of conducive enabling environment that allows pro-SME financial products and services to organically develop in the financial marketplace, with as little direct government intervention as possible. Put another way, current best practice in SME financing places greatest emphasis on the notion of market-driven and sustainable finance provision, instead of direct substitution and subsidy. Such initiatives tend to:

i) be more sustainable in the long-run;

ii) entail fewer distorting side-effects;

iii) incur fewer costs for the government, and the economy as a whole; and

iv) be less susceptible to misdirection.

When emphasis is placed on achieving the greatest positive impact, relative to the costs incurred, it is apparent that government agencies should focus a large proportion of their efforts in seeking to remove regulatory and other obstacles that prevent or inhibit the financial market operating more effectively in supporting the financing needs of SMEs. These obstacles may be on the 'supply side' (ie. pertaining to the banking and finance sector) or the 'demand side' (ie. pertaining to SMEs themselves, such as their book-keeping capacity). They may be obstacles that occur in the external business and finance environment as a whole, or be internal constraints within individual banks and SMEs.

In cases where it also deemed desirable that government agencies get involved directly, to assist in introducing new financial products and services tailored to meet the needs of the SME sector, their role should ideally be a catalytic one; coordinating their introduction and initial development. But government agencies should not, wherever possible, seek to become directly involved, in an on-going or operational basis, as financiers or bankers to the SME sector (or indeed, any element of the wider corporate community). That is a role usually best left to commercial banks and finance companies. It also can give a mistaken signal to commercial banks and finance companies that SME sector financing in general is unviable and that individual SMEs are 'unbankable'. But as experiences in a number of developing countries have shown, SME-oriented lending can indeed be a very profitable source of business for banks.

Government Lending and the Public Policy Process

Perhaps the best way to avoid some, if not most, of these problems is through careful consideration of the various options for using government loans, and to gauge their possible impacts. After all, government lending represents a form of intervention and, like all forms of government intervention, should be subjected to a robust review process before implementation. This is to ensure that the intervention generates a net-positive impact on the economy, or at least that the negative impacts of the intervention are minimized.

In this way, the Prime Minister's Strategy Unit (PMSU) in the UK, drawing upon standard regulatory review principles, outlines a useful set of criteria to assess the appropriateness of using government loans to achieve certain social and economic objectives. These criteria are summarized in Graphic 1, and could be applied to any situation where governments are considering the use of loans to achieve their policy objectives.

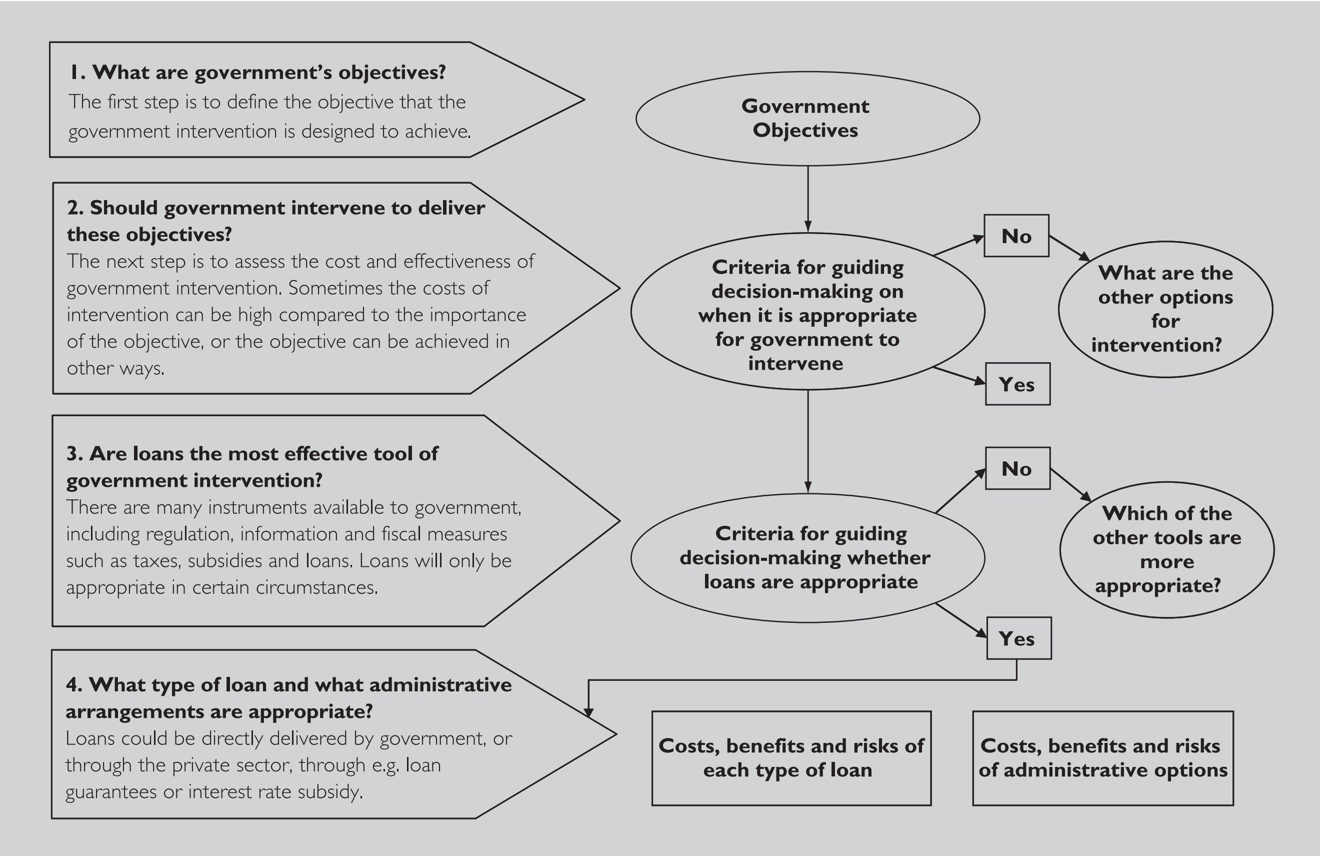
In determining whether the government should intervene, the PMSU advises that the first step is to clearly identify the precise objective(s) that government intervention is designed to achieve. In the case of the policy lending to SMEs, the objective would be to improve SME access to finance. If this was going to be objective then it would first need to be confirmed that access to finance for SMEs is indeed a problem.

The second step is to decide whether government intervention is necessary to achieve those objectives. The two most common justifications for government intervention are typically: i) to help overcome 'market failures'; and ii) to promote equitable provision. In each case, both could be feasibly used to justify government loans to SMEs. For example, it could be built on the argument that the market is failing to extend sufficient credit to SMEs, or that more loans are required to SMEs to achieve certain poverty alleviation objectives.

It may be the case that direct government action is not required, and some sort of market-based solution maybe the best course of action. However, if it is deemed that the government should intervene, the third stage is to determine what is the best tool for that intervention. This requires a consideration of a range of policy options. In the case of improving SME access to finance, alternatives to government lending may include regulatory reform measures intended to facilitate bank lending to SMEs, government initiatives to improve access to information or to improve SME book-keeping capacities, or even possibly fiscal measures such as tax reform. Ideally in each case, the costs and benefits should be measured and compared. The government lending option should be pursued only if it has been shown to generate the highest net-benefits, relative to the other policy options.

This brings us to the fourth stage, where we must consider what type of loan and administrative arrangements are appropriate. Key issues to be considered here are: i) whether the loan should be delivered by the government or through the private sector (perhaps as some kind of credit line); ii) or whether the assistance should be through loan guarantees or interest rate subsidy; iii) or some other kind of mechanism. In each case, the costs, benefits and risks of each type of loan and administrative arrangement need to be considered carefully and systematically.

Figure 1. Criteria within a policy process where loans are under consideration



Source: "Lending Support: Modernising the Government's Use of Loans", Prime Minister's Strategy Unit, U.K. (www.strategy.gov.uk)

Examples of Government Lending to SMEs

Despite the various drawbacks of government lending to SMEs discussed above, and the rigorous review process that any government lending program should be subjected to prior to its implementation, it is interesting to note that such programs are commonplace in both the developing and developed world, at both the national and sub-national levels. Whilst there might be some question as to the efficacy of these loans programs, public officials nevertheless commonly see policy loans as a valid tool to promote SME development. Discussed below are a number of examples of government loans programs for SMEs.

The United States Small Business Administration (SBA) is a federal government agency charged with the responsibility of 'aiding, counselling, assisting and protecting small business.' The SBA offers a range of loan programs to assist small business, usually functioning as a guarantor of loans made by private and other institutions (see next section for a discussion of loan guarantee programs).

The Basic 7(a) Loan Guaranty serves as the SBA's primary business loan program to assist qualified small business otherwise ineligible for loans through normal commercial channels. Loan proceeds can be used for a variety of business purposes including working capital, equipment, office fittings, land and building and debt refinancing. Loan maturity is up to 10 years for working capital, and up to 25 years for fixed assets. Loans are delivered through commercial lending institutions.

The Certified Development Company Program (504 Loan Program) provides long-term financing for SMEs to acquire land or equipment. The loan is provided by a commercial lender with a senior lien, and a Certified Development Company (CDC, a private non-profit regional development organization) with a junior lien, and the borrower providing at least 10 percent equity.

The SBA also has a micro-credit program, known as the 7(m) Program, for short-term loans of up to $35,000, delivered through non-profit organizations with experience in lending. An additional service provided by the SBA is the Loan Prequalification Program which allows business applicants to have their loan applications for $250,000 or less analyzed and potentially sanctioned by the SBA, prior to being submitted to lenders for consideration.

Another federal agency, the USDA, also provides a number of programs to deliver loans to small business in rural areas of the US. Most lending is through the Business and Industry Guaranteed Loan Program which provides guarantees of up to 80 percent of a loan made by a commercial lender. Loan proceeds can be used for working capital, equipment, buildings, land, and in some cases debt refinancing.

In addition to federal agency programs, most states and many municipalities and counties in the US sponsor a variety of government loans for small business concerns. One popular form of lending at the state level is a participating loan arrangement in which the state pools its public funds with money from a commercial lender. For example in Illinois, the state may loan up to 25 percent of the total cost of a small business project, with a maximum loan of $750,000. This means that for a $100,000 loan, the bank would only lend $75,000 and the state would 'participate in the loan by contributing public funding of $25,000 to the total loan package. The bank then processes the total loan of $100,000. The bank, rather than the state, is responsible for all management and administration tasks associated with implementing the loan, including risk assessment. This last point is important to note, as it is not a core competence of state officials to administer loans[1].

Government lending programs to SMEs are also commonly found outside of the US. Britain for example has the Phoenix Fund, a policy instrument of the Small Business Service (SBS), under the UK Department of Trade and Industry. The fund has the objective to 'encourage enterprises in disadvantaged communities and in groups under-represented in terms of business ownership.' As is the case with the US lending programs discussed above, loans are not directly available from the SBS, rather they are channelled through specialist business support providers and financial intermediaries.

Singapore is another country with government lending programs to promote SME development. The Standards, Productivity and Innovation Board of Singapore provides a number of government loan schemes for small business, delivered by participating financial institutions. This includes, amongst others: i) the Local Enterprise Finance Scheme, a loans program designed to assist SME upgrade their operations, by improving access to finance to cover factory and machinery investment, as well as hire purchase and working capital requirements; ii) the MicroLoan Scheme, designed to help very small enterprises get better access to financing; and iii) the Variable Interest Loan Scheme, designed to assist participating financial institutions to use varying interest rates to match the risk profile of SME borrowers.

Credit Guarantee Systems

A policy instrument often used to support commercial bank lending to SMEs has been the provision of partial loan or credit guarantees.[2] Using such guarantees, banks are able to share a proportion of their loan risk with a credit guarantee agency, for a fee (or 'guarantee premium'), and therefore should be more willing to lend to SMEs. Partial loan guarantees can also lower - but not wholly remove - the collateral requirement that often proves to be the main obstacle for SMEs in accessing formal financing. Most credit guarantee systems (CGS) have been established as wholly government agencies or special public bodies, although some have been structured as commercial enterprises. Most CGS provide a 'retail' guarantee service (ie. guaranteeing individual loans), although some may provide a 'portfolio' or 'blanket' guarantee on all or part of a bank's loans in a specific area. The coverage tends to range from between 50-100% of the loan amount (only principal, and not interest).[3]

Despite there apparent popularity,

1. This example is drawn from the CCH Business Owners Toolkit, an online resource available at www.toolkit.cch.com.

2. Also sometimes referred to as 'credit supplementation'
3. The provision of 100% guarantees heightens the risk of 'moral hazard' by the banks, particularly if they are not co-investors in the CGS itself.

particularly in Asia, CGS are a controversial instrument, with a lively and on-going debate as to their real utility and desirability. Some experts argue that CGS contain too many risks (see below), although recent years have seen a re-evaluation of such systems, and some would argue that they can be viable and useful, if they are designed and operated according to 'best practice' lines. These best practices include: i) being managed by a legally autonomous agency; ii) funding from both government and private sector sources; iii) experienced management and staff; iv) operating on a profit-oriented basis; v) a selective approach to coverage, and focus on specific target groups; vi) a suitable distribution of risk across lenders, borrowers and the guarantee agency itself; vii) the provision of training and other support to borrowers (ie. firms) and lenders (ie. participating banks); viii) an appropriate fee structure; ix) vigorous loss recovery; x) partial reinsurance through a counter-guarantor; xi) the development of trust and credibility with borrowers and lenders; xii) building up reserves for sustainability; xiii) limited government interference; and xiv) and robust regulation and supervision on capital adequacy, risk management, accounting standards, etc. (as one would find for commercial banks).[4] Also, the CGS should only provide partial guarantees, of probably no more than 50% of any single loan.

4. See UNIDO's 'Credit Guarantee Schemes for Small Enterprises' (2003).

The principal attraction of CGS is that it allows participating banks and other sources of debt financing to share some of the risk entailed in lending to SMEs. This in turn should encourage banks and other loan providers to lend more vigorously to the SME sector, including some firms that banks would not normally take as clients if they alone bore the risk of loan default.

However, the operation of a credit guarantee system comes with a number of preconditions and risks. The main precondition is that the CGS must have a good risk assessment process, if it is to be sustainable. If its risk assessment is inadequate, clients (ie. lending institutions) will not see the utility of using its service for a fee, and/or these fees will not be sufficient to cover calls made on the guarantees, ultimately rendering the CGS insolvent. The main risk is that banks will aggressively lend to SMEs, in the knowledge that repayment is partially guaranteed, and therefore will not conduct adequate credit appraisal processes of their own.[5] There is also a risk that bank loans get directed towards non-profit generating projects, such as loss-making SOEs, thereby accruing capital losses for the government, and perpetuating the misallocation of funds. It should also be noted that: i) the fixed costs of operating a guarantee agency can be substantial; and yet ii) the utilization of credit guarantees by banks and SMEs is sometimes lower than expected.[6] Banks are often concerned that any claims to the CGS will not be met, or entail considerable bureaucratic delay – such a lack of confidence can render a CGS virtually useless.

5. This assumes that banks are confident that the CGS will honour its commitments, and in a timely manner. In cases where banks are not confident that the CGS will do so, its utility is limited, at best.

Indeed, some research suggests that credit guarantee systems are fundamentally unsustainable for developing countries, as the administrative and operating costs are too high, particularly where retail guarantees are provided.[7] Some commentators have gone further, and argue that the introduction of credit guarantee systems can "do more harm than good", by increasing the danger of 'moral hazard' for the banking sector, and can "contribute to a weakening of credit morality".[8] Tellingly, all the CGS operating in Southeast Asia are run by government agencies (and probably incurring losses), with no private and profit-oriented credit guarantee company yet to be established in the region.

Models of apparently successful SME-oriented CGS include Kredex in Estonia, Finnvera plc in Finland, Credit Orienwise in China, and USAID's global Development Credit Authority (DCA), amongst others. Founded in 2001, through the merger of three previous funds, Kredex provides loan and lease guarantees for SMEs (up to 75% for loans and 40% for leases), short and long-term export credit guarantees for SMEs, and home loans guarantees. Although initially established by the Ministry

6. See 'Credit Guarantee Systems for SMEs in some Asian Countries', pp. 65-68.
7. See 'Sustainability of Credit Guarantee Systems'.
8. See 'Credit Guarantee Schemes for Small Business Lending', pp. 1-5.

of Economic Affairs (which also injected the founding equity capital), Kredex is not subsidized by the government, and claims to have been profitable in its first three years of operations. Kredex's primary aim is to encourage entrepreneurship in, and export earnings by, Estonia's corporate sector, and its guarantee services are focused primarily on small and start-up ventures.

Finnvera is a specialized finance company, providing loan guarantees as part of a suite of financial products to help promote Finnish companies, including SMEs and start-up ventures. Although officially owned by the government (under the aegis of the Ministry of Trade and Industry), Finnvera is a profit-oriented company. It does, however, receive subsidy support from the government, taken from the national budget's allocation for industrial and regional development. Finnvera has over 400 staff, distributed across 16 regional offices, with over 25,000 clients on its books.

Shenzhen Credit Orienwise Co. Ltd. (Credit Orienwise) is the largest private credit guarantee company in China, with revenues of just under US$22m in 2004, and outstanding guarantees of US$226 million in 2003. The company has focused exclusively on guaranteeing SME loans. In April 2005, the Asian Development Bank made a direct investment in Credit Orienwise, reportedly paying US$10m for a minority stake.

Since 1999, DCA has provided partial credit guarantees for private investments in numerous developing countries, working through non-state owned financial institutions. The principal aim of DCA is to reduce the risk for banks associated with lending to new sectors or new borrowers. The partial guarantees can be for individual loans or portfolios of loans. In Vietnam, DCA has provided portfolio guarantees of US$5 million each to two joint stock banks (Asian Commercial Bank and Eastern Asia Commercial Bank), for loans extended to private SMEs. Other SME-oriented CGS include: CESGAR in Spain, KOTEC in South Korea, SOFARIS in France, the Small Firms Loan Guarantee Scheme in the UK, and the Small Business Administration Guarantee Scheme in the US.

In Vietnam, Decree 90 of November 2001 called for the creation of credit guarantee funds, by commercial banks, specifically to support lending to SMEs with insufficient collateral.[9] Under the Decree, such funds are to be established in each province and major municipality, under the relevant people's committee as non-profit entities. The funds are to be capitalized at VND30bn each, with 30% of the money coming from the local budget, and the balance from banks, business associations and firms. Each fund is to have a management council, supervision board, and an executive board, with the latter delegated to the local respective DAF office, on a fee-paying basis.[10] As far as we are aware, no credit guarantee funds have actually become operational in Vietnam, principally due to a series of difficulties contained in their current design. However, it was reported in March 2006 that HCM City People's Committee has plans to establish a CGS Fund for SMEs, initially capitalised at VND50 billion (bn).[11]

9. Decree 90 is supported by Decision 193 (December 2001) of the Prime Minister, Circular 42 (May 2002) of the Ministry of Finance, and Circular 6 (April 2003) of the State Bank of Vietnam.
10. The Development Assistance Fund (DAF) was established in 2000, under Decree 50, of July 1999, with start-up capital of VND5 trillion. Its mandate is to serve as a non-profit agency, mobilizing capital resources to support state policies and initiatives.
11. See Vietnamnet, 28th March 2006. The report suggests the Fund will guarantee up to 80% of the difference between the value of the loan and the value of assets pledged as security. A fee of 1% of the guarantee is to be charged for the service.

METHODOLOGICAL APPROACH OF THIS TWO-PART SURVEY

This study aims to shed light on the policies and practices of subsidised lending, or policy lending, in three locations in Vietnam. The approach taken was to look at the issue from both the 'supply side' and the 'demand side', namely: i) the providers of subsidised loans; and ii) companies actually receiving such loans, or eligible to receive such loans. We decided to focus on just three locations in the south of Vietnam: i) the economic hub of Ho Chi Minh City; ii) Binh Duong province, to the immediate north of Ho Chi Minh City; and iii) the Mekong delta province of Tien Giang. These three locations provide a representative sample of the diverse range of economic conditions to be found in Vietnam (see table 1 below). They are also all hosts to: i) a branch of the national Development Assistance Fund (DAF), which has an office in every province and major municipality of Vietnam; and ii) their own provincial assistance fund (or PAF).

Table 1: The Three Sample Locations Compared, Some Indicative s

All figures as at end-2002	Tien Giang	Binh Duong	HCM City	National average
Population (thousands)	1,660	851	5,555	-
Monthly average per capita income at current prices (VND thousand)	352.2	504.3	904.1	356.1
Number of enterprises	1,333	1,704	14,506	-
Number of enterprises with less than 50 employees	1,228	1,015	11,796	-
Number of enterprises with over 1,000 employees	2	35	177	-
Number of enterprises with capital resources of less than VND1 billion	1,007	506	6,410	-
Number of enterprises with capital resources of over VND200 billion	4	38	241	-
Average number of employees per company	26	151	74	74
Average capital per company (VND billion)	3	25	20	23
Tax revenues paid to the national budget (VND billion)	404	2,042	21,430	-
Number of firms with a computer	223	1,152	10,698	-
Number of firms connected to the internet	73	669	6,056	-
Number of firms with a website	16	100	781	-
Industrial output value (VND billion, at constant 1994 prices), estimate for 2003	1,650	14,361	75,697	-
Industrial output value of domestic firms (VND billion, at constant 1994 prices), estimate for 2003	1,063	5,730	54,412	-
Industrial output value of private firms (VND billion, at constant 1994 prices), estimate for 2003	666	5,040	22,854	-
Net turnover of companies (VND billion)	10,006	39,802	363,624	-

Sources: Statistical Yearbook 2003 and The Real Situation of Enterprises, both published by the Statistical Publishing House, Hanoi, 2004.

Case Study Approach for the Providers of Subsidised Loans

There is relatively little information in the public domain pertaining to the providers of subsidised loans in Vietnam. Gaining access and information to these agencies is not always easy, and at the commencement of this study it was not clear how much insight our study would be able to derive. It was therefore decided to take an exploratory approach, seeking to build up a basic profile of the three DAF branches and three PAFs operating across the sampled three locations. This provided us with two simple case studies, comprising: i) the broadly similar DAF branches in the three locations; and ii) the more divergent PAFs operating in each of the three locations. These two case studies are provided in section 5 of this report.

Quantitative Survey Approach for the Recipients of Subsidised Loans

To complement the exploratory approach taken towards the providers of subsidised loans, it was decided to conduct a more quantitative approach in studying the recipients of such loans, through the use of a company survey. A sample comprising 230 firms, from both the state-owned and private sectors, was compiled across the three locations. More specifically, 170 companies from Ho Chi Minh City, 40 from Binh Duong, and 20 located in Tien Giang were selected and surveyed. This sample weighting – of 170-40-20 – is proportionate with the number of firms eligible for subsidised loans in each of the three locations. Table 2 shows the distribution of the study sample, by location, and the number of enterprises attaining and not attaining credit incentives. As can be seen, the sample consisted of two equal parts: i) 115 firms receiving subsidised loans, and 115 firms not receiving subsidised loans.

The actual selection of specific firms was done by random. Company interviews were based on structured questionnaires, so as to try and ensure consistency of information provided. Across all of the questionnaires, there was a consistent structure, comprising three sections: i) general information on the firm, for purposes of identification and profiling; ii) issues and practices pertaining to policy loans; and iii) a section that sought to gauge firms' general knowledge of, and perceptions towards, subsidised loans provided by their respective DAF branch and PAF. However, the questionnaire used for those 115 firms receiving subsidised loans differed from the questionnaire used for the 115 firms not currently receiving such a loan with respect to the middle section, on the issues and practices pertaining to the policy loans. For companies receiving such loans, they were asked in detail about the kind of loans they had attained, and the procedures they had gone through. For those firms that had not yet received such a loan, they were asked about the reasons this, their interest in such loans, and the likelihood that they would be able to receive such a loan in the future. The first and final sections of the questionnaire were uniform across both sub-samples. The questionnaires included both open- and close-ended questions. Frequency analysis was applied for some quantitative variables for each sample subject, as well as for the whole sample. Comparisons between companies attaining and not attaining subsidized loans, and between companies in each province, were also derived. In addition, based on the findings, an attempt was made to gauge the relative effectiveness of subsidized lending policy, principally in terms of their cost-effectiveness.

Table 2: Sample Distribution

	HCM City	Binh Duong	Tien Giang	Total sample
Enterprises receiving subsidised credit	85 (36.95%)	20 (8.7%)	10 (4.35%)	115 (50%)
Enterprises not receiving subsidised credit	85 (36.95%)	20 (8.7%)	10 (4.35%)	115 (50%)
Total	170 (73.9%)	40 (17.4%)	26 (8.7%)	230 (100%)

Note: Number in () is the percentage of total study sample.

EMPIRICAL FINDINGS: PART ONE

Legal Framework for Policy Lending in Vietnam

Policy lending in Vietnam is implemented at two levels: national (or central) and provincial. Central policy lending is carried out through the Development Assistance Fund (DAF), while provincial policy lending is channeled through provincial assistance funds (PAFs). Each of the systems operate under a different legal framework.

At the Central Level

As a state financial organization, the organization and operation of DAF is regulated by various legal documents issued by central government and its relevant bodies. The first group of documents relates to DAF's organization and operations, including its internal financial management. These include: Decree 50/1999/NĐ-CP (July 1999) on the Organization and Operation of DAF; Decision 231/1999/QĐ-TTg on the Approval of DAF's Charter; Prime Minister's Decision 59/2005/QĐ-TTg (March 2005) on the Regulations for DAF Financial Management, and Circular 51/2005/TT-BTC (June 2005), providing guidance on the implementation of Decision 59. These relatively recent documents supersede Circular 42/2000/TT-BTC and Circular 43/2000/TT-BTC (of May 2000).

The second group of documents largely pertain to the management of development credit and export finance credits. These documents stipulate the eligibility requirements of recipients, and the extent of funding assistance. These documents also serve as the legal framework for DAF's internal regulations and operations pertaining to financial appraisal, the lending of development credits, post-investment interest subsidies, the settlement of credit risks associated with the State Development Investment Credit, and export finance credit. These documents include: Decree 51/1999/NĐ-CP (July 1999) on the implementation of the Law on Domestic Investment; Decree 106/2004/NĐ-CP (April 2004) on the State Development Investment Credit (which supersedes Decree 43/1999/NĐ-CP); Decision 133/2001/QĐ-TTg (September 2001) on the Regulations for Export Finance; Decree 178/1999/NĐ-CP (December 1999) on loan recovery assurance of credit organizations; Circular 89/2004/TT-BTC (September 2004) on the settlement of credit risks associated with the state development investment credit. Besides these documents, issued by the government and relevant ministries, there are various documents issued by DAF itself, to guide its operational procedures on such issues as investment appraisal and lending; capital mobilization, the Development Investment Credit at DAF; decentralization of lending decisions and management of projects; etc.

Decree 106/2004/ND-CP sets our the framework for the following kinds of credit subsidy: (1) investment development credit, (2) post-investment, and (3) credit guarantees. The short-term export financing activity is carried out congruent to Decision 133/2001/QD-TTg. The on-lending of ODA funds is carried out in accordance with Decree 87/ND-CP (August1997) and Decree 90 (November 1998) on the management and repayment of foreign debt. The list of eligible projects, development credit interest rates, and the list of exporting products entitled to export finance subsidies, are subject to occasional changes, as declared by the Ministries of Finance and Trade.

At the Provincial Level

PAFs are regarded as experimental models of state financial investment funds. And as such, there is no uniform state legal framework for these funds, as yet. Each PAF operates under the specific legal framework established by the relevant provincial or city people's committee, as well as a package of internal guidelines issued by the fund itself.

HCM City's PAF - called HIFU (the HCM City Fund for Urban Development) - was the first PAF to be formed. It was established by Prime Minister's Decision 64/TTg of October 1996, and its management of financial matters is stipulated in

Circular 43 TC/TCNH of July 1999, issued by the Ministry of Finance. All the other PAFs were established by decisions of the relevant provincial people's committee, and their charters (including that of HIFU) were also approved by the provincial people's committee. Each PAFs has selected its own "model" to manage its financial matters. For example, Tien Giang's PAF has been using Decree 10/ ND-CP on "financial management of governmental administration agencies with revenue" to guide its financial matters, while Binh Duong's PAF has been replicating HIFU's model.

There is also a group of documents pertaining to the management of investment, construction and infrastructure activities, which stipulate the necessary procedures and conditions that potential borrowers must meet. These documents include: Decree 52/1999/NĐ-CP (July 1999) on the Regulations for Management of Investment and Construction, Decree 16/2005/NĐ-CP (February 2005) on the Management of Construction Projects, and some other relevant circulars.

In summary, the legal framework for provincial policy lending is not consistent and uniform for all provincial funds, particularly relating to the management of these funds. Also, there does not yet exist any accounting principles for their activities, and so, depending on the chosen "model" of financial management, each fund has its own unique accounting system. The provincial and central lending policies at DAF and the PAFs are broadly the same in terms of providing loans at preferential rates. However, only DAF provides post-investment interest rate subsidies and guarantees, while only PAFs are able to make direct equity investments.

For more detailed information, see *Appendix 1 Legal Documents that Regulate DAF's Activities*

Case Study of DAF Branches in HCM City, Tien Giang and Binh Duong

DAF and It's Products and Operational Procedures

DAF's Legal Status and Major Functions

The Development Assistance Fund (hereafter DAF) is a state financial institution, established in July 1999. Its organizational structure and operations are primarily regulated by the Law on Domestic Investment and Decree 50/1999/NĐ-CP, also of July 1999. DAF receives capital (from both domestic and overseas sources), as allocated by the government. It also mobilizes its own medium-term and long-term capital, in compliance with State policy. DAF's primary functions include:

- Providing loans to medium and long-term development projects at preferential rates of interest;
- Providing post-investment interest subsidies;
- Providing guarantees on investment loans;
- Providing an on-lending service for ODA, towards specific investment projects;
- Providing short-term credit to finance exports.

DAF's Organization

As a governmental organization, DAF's Charter is approved and modified by the Prime Minister. The Prime Minister also issued legal documents that regulate DAF's operations, notably: Decree 106/2004/NĐ-CP on the State Development Investment Credit, and Decision 59/2005/QĐ-TTg on the Regulation of Financial Management of DAF. Even though DAF reports directly to the Prime Minister's Office, its operations are closely connected to other State agencies, including:

- Ministry of Finance (MoF): The Minister directs DAF operations on behalf of the Prime Minister, and makes decisions on:
    - Borrowing and lending interest rates of DAF at regular intervals;
    - Coordinating with relevant ministries to create a list of qualified recipients of preferential investment loans, for each specific period;
    - Assigning DAF to receive and manage state capital;
    - Guiding, inspecting, and monitoring DAF in its implementation of assigned tasks;
    - DAF reports on a regular basis to the MoF, on its operations and budget planning, and other relevant financial matters.
- Ministry of Planning and Investment (MPI):
    - DAF reports to MPI on its plans for sources of capital, and total credits granted in the form: of medium- and long-term loans with preferential interest rates, credit guarantees,

credit under-writing, export finance credit, post-investment interest subsidies. This is partly so that the MPI can prepare the annual credit plan for DAF, which is then submitted to the Prime Minister.

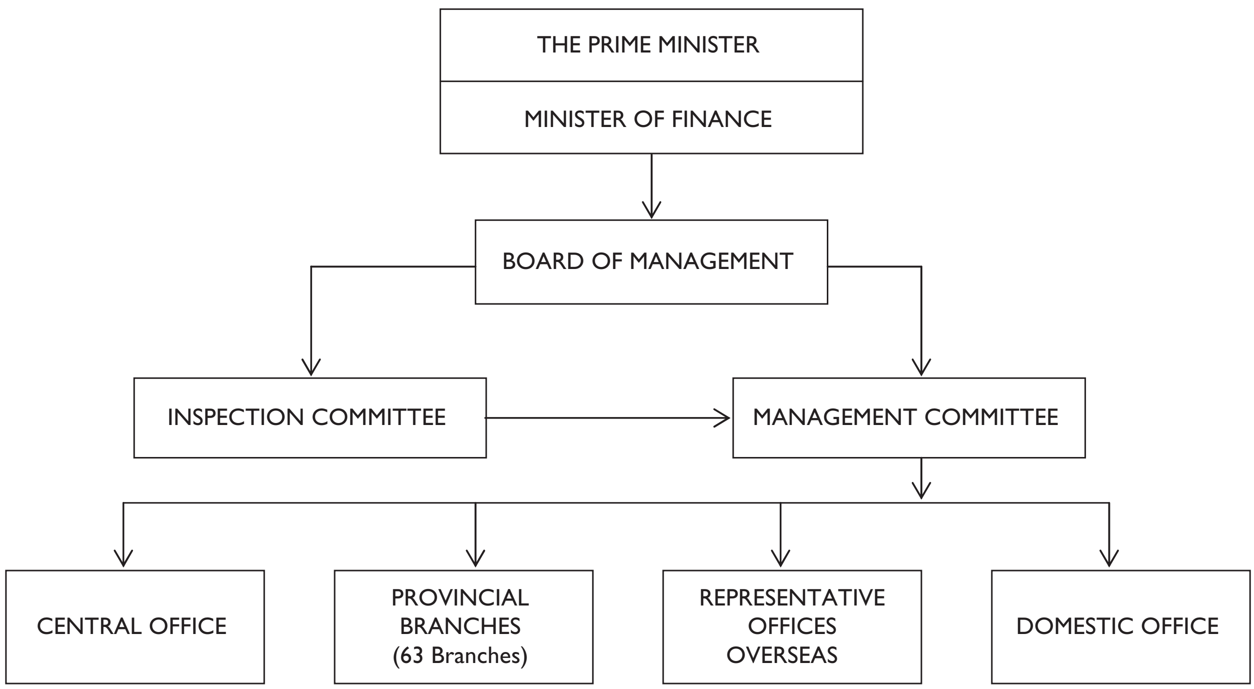
- The State Bank of Vietnam (SBV):
  - Guiding, inspecting, and monitoring DAF in its implementation of monetary and foreign exchange policy, and its credit policies relating to state development investment credits.
  - Directing credit institutions to coordinate with DAF in receiving entrusted loans from DAF, and in lending to projects under-written by DAF or granted post-investment interest subsidies.

- Ministries and ministry-level agencies under the Government, and People's Committees at the provincial and municipal level:
  - Directing and inspecting investors during implementation of DAF-supported projects, in compliance with State regulations;
  - Coordinating with DAF to deal with suspended projects or projects that are unable to re-pay their financing.

DAF's Board of Management consists of five people: a Chairman, a Vice-Chairman, and three others, including the deputy ministers from MoF, the MPI, and the Deputy Governor of the SBV. DAF's Board of Management issues internal regulations that govern operations, such as: Regulations on Financial Appraisal; Regulations on DAF Mobilization of Funding; Receipt and Management of the State Development Investment Credit; Regulations on Lending of the State Development Investment Credit; and Regulations on Post-Investment Interest Subsidies. The Inspection Committee monitors DAF operations. The Chief Inspector also attends Board of Management meetings, but does not vote.

DAF's provincial branches implement DAF operations in their respective localities. All branches operate under a uniform framework that regulates the whole DAF system. No single branch may have its own regulations. DAF branches may make lending decisions within their assigned capacity, as stipulated by the General Director.

Figure 1: DAF's Organizational Structure



DAF's Financial Management

DAF is a non-profit organization, but its operations are expected to be self-financing and entail the recovery of funds, so as to be sustainable in the long term. DAF implements the centralized financial management policy. All the cash flows of DAF are moderated by and through DAF's headquarters, and are not circulated freely between DAF's branches. All funds are located in central DAF and then channelled to branches as needed. DAF's branches can retain a certain amount of funds, within limits set for each branch by the General Director. For more details of DAF's financial management, see ***Appendix 5 Brief Profile of DAF's Financial Management.***

DAF's Source of Funds

DAF's operating capital stems from a number of sources, including the following:

- Capital granted by the State budget, including:
  - DAF's chartered capital of VND 3,000 bn, first granted by the State budget upon its formation in 1999. DAF's current chartered capital now stands at VND 10,000 bn.
  - Annual additional capital from the State budget, used to: increase DAF's chartered capital, undertake credit guarantees or other governmental-directed programs and projects, or to provide loans to projects in accordance with the agreements signed by the government.
- Mobilized capital from various sources, including:
  - State bond issuance, in the form of underwriting, auctions, or ordinary issuances by the Treasury.
  - Loans from various funds, such as the Post Office Savings Fund, The Social Insurance Fund, and The Accumulated Fund to Honor Foreign Debts, etc.
  - Loans from domestic and foreign banking and finance organizations, in the form of loan contracts, time deposit accounts, etc.
  - Capital entrusted by domestic and foreign organizations, in the form of time deposit accounts or contracts, to be used for on-lending by DAF.
  - Capital mobilized from other sources, in accordance with laws and regulations.
- ODA loans to Vietnam, assigned to DAF, for subsequent on-lending.

Table 3: DAF's Operating Capital, 2002 to 2004 (VND Bn)

	2002	2003	2004
Total capital	23,754	37,642	46,361
Legal (chartered) capital	4,981	4,981	4,981
Mobilized capital	18,773	32,661	41,380
- Loans from funds	14,194	15,585	17,269
- Bond issuances	2,176	10,529	16,357
- Capital mobilized by DAF's provincial branches	495	2,318	4,273
- Other mobilized funds	1,908	4,229	3,481

Source: Report of DAF Inspection Committee

DAF assets have increased significantly in recent years. As of end-2004, DAF's total assets were VND 46.36 bn (approximately US$2.9 bn, equivalent to 6.7% GDP); compared to VND37.64 bn at end-2003 and VND23.75 bn at end-2002. Most of the funds are borrowed from other funds, such as the Post Office Savings Fund, The Social Insurance Fund, The Accumulated Fund to Honor Foreign Debts, and from the issuance of government bonds. Unlike, commercial banks and other credit organizations, DAF does not receive deposits from the public.

DAF's Products and Services

The products and services provided by DAF are broadly as follows:

- Providing loans to medium and long-term development projects at preferential rates of interest;
- Providing post-investment interest subsidies;
- Providing guarantees on investment loans;
- Providing an on-lending service for ODA, towards specific investment projects;
- Providing short-term credit to finance exports
- Providing on-lending service for entrust funds
- Making investments on behalf of the Government, congruent with government agreements.

DAF's loan products are generally similar to those offered by commercial banks. The principal distinction is that DAF's interest rates are markedly lower than that of the market average, and the collateral requirements are sometimes more flexible than those stipulated by commercial banks. DAF's interest rates also tend to be fixed, without any change during the loan period, while commercial banks often apply floating rates of interest on corporate loans. Projects granted development credits are allowed to use assets financed by loans as collateral, and thus the requirement on minimum equity is generally lower than that for commercial bank loans. However, the recipients of DAF loans are limited to certain industries and locations. The more flexible collateral requirement increases default risk, particularly as eligible projects under Decree 106/2004/NĐ-CP tend to be large and long-term projects.

The only DAF product that is markedly different from that of commercial banks is post-investment interest subsidies. This product is an 'arms-length' financial tool, which seeks to induce investment into focal industries by investors other than government. It is intended to promote the "socialization" of investment into select industries that are deemed to be in particular need of development.

DAF's Lending

DAF's lending results, as of end-September 2004, are shown in table 4.

As of end-September 2004, DAF had provided subsidised loans to 6,571 projects, of which 6,342 of projects (96.5%) were provided with credit that had been sourced domestically. Only 3.5% of the projects (229 projects) stemmed from ODA loans. However, domestic funding accounted for VND 39,850 bn, equivalent to 58.4% of total loan commitments, while ODA funding accounted for 41.6% (VND 56,035 bn).

By end-September 2005, the total value of subsidised loans amounted VND 96,960 bn, of which mid- to long-term credits accounted for the biggest share by far (at 81.5%), followed by short-term export finance (17.7%). Guarantees are not very significant, as DAF has only underwritten five projects, with total capital of VND 30 bn. DAF has also provided post-investment interest subsidies for 1,300 projects, with a total amount of VND 750 bn.

Table 4: DAF's Lending Results, as of September 2004

	Domestic Credit	ODA	Total
Number of projects	6,342	229	6,571
Ratio	96.5%	3.5%	100%
Loan commitments (VND bn)	39,850	56,035	95,885
Ratio	58.4%	41.6%	100%

Source: DAF

Table 5: Amount of DAF Lending, by Form of Loan

	Value of Contracts (VND bn)	Proportion
Government programme loans (mid- to long-term development credit)	78,980	81.5%
Short-term credit to finance exports	17,200	17.7%
Guarantees	30	0.03%
Post-investment interest subsidies	750	0.8%
Total	96,960	100.0%

Source: DAF

Projects for the development of electricity supply received the largest proportion (53.1%) of investment development credit. In contrast, rural infrastructure development projects accounted for only 8.7% of total development credits.

DAF's Operational Procedures

DAF Appraisal and Lending Procedures

In order to receive DAF development credit, a project must follow a set appraisal procedure. The project owner submits the project outline to the relevant appraisal agencies, of which DAF assesses the financial and economic elements. Projects eligible for consideration must meet the criteria set in Decree 52/1999/NĐ-CP (July 1999) on investment and construction. Construction projects must also comply with regulations in Decree 16/2005/NĐ-CP (February 2005) on construction project management. The appraisal by DAF depends on the project category:

- For Category A projects, the Prime Minister makes the investment decision, and Central DAF provides guidance on the project, and appraises the project.
- For other Category A projects, the General Director of DAF organizes the appraisal.
- Provincial DAF branches directly receive applications from, and provide guidance to, Category B and C projects. Provincial branches are divided into three groups, depending on their capacity. Group I (including DAF branches in HCM City and Binh Duong province) may appraise and make lending decisions to Category B and C projects; Group II branches (including the DAF branch in Tien Giang province) may only appraise Category C projects, and Category B projects with investment capital not exceeding 50% of the maximum capital associated with B projects (ie. between VND 200 to 600 bn); and Group III branches may only appraise Category C projects.

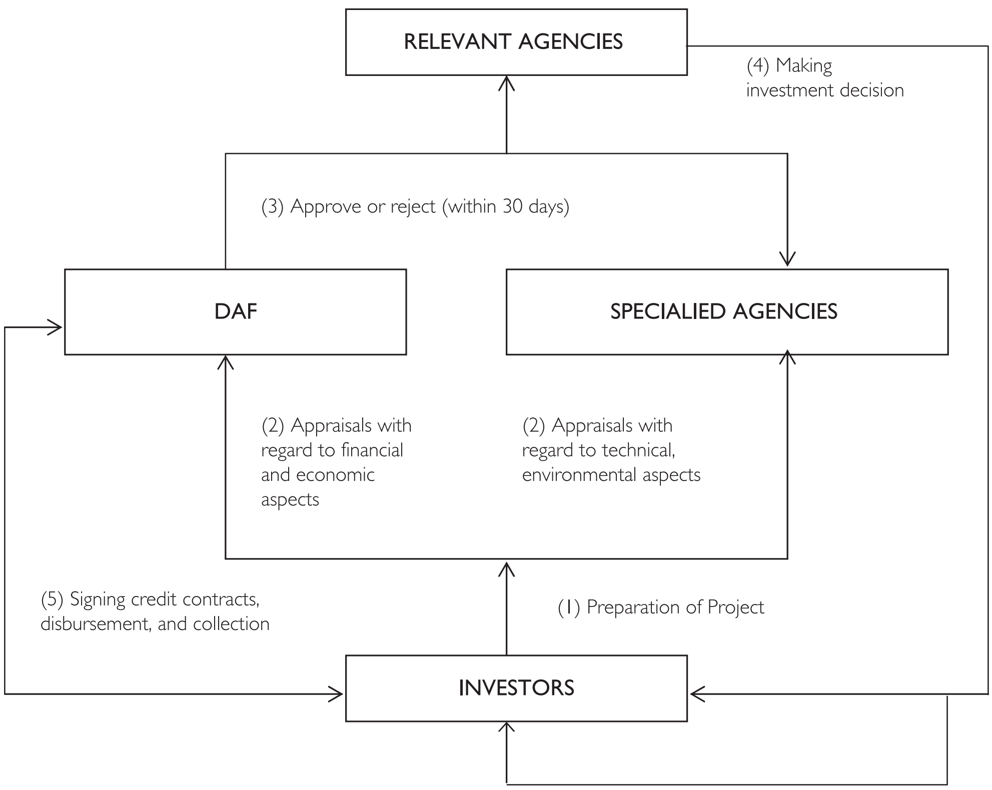
Within 30 days, DAF will notify the appraisal results to the relevant agency responsible for the investment decision. If the project is approved, the relevant agency will make the investment decision. The project owner and DAF will then sign the loan contract.

Table 6: Amount of DAF Lending, by Form of Loan

	Amount (VND bn)	Proportion
New forest plantation of 5 hectares	1,036	1.3%
Development of electricity supply	41,937	53.1%
Enhancement of channels, transportation systems, infrastructure of professional villages	5,268	6.7%
Accelerating the development of the garment and textile industry	3,752	4.8%
Promoting exports	6,509	8.2%
Developing shipping	3,123	4.0%
Cement program	5,728	7.3%
Steel program	2,677	3.4%
"Raising bases over floods in flooded areas of Mekong Delta" program	1,601	2.0%
Building of new railroad cars	628	0.8%
Producing and processing agricultural, forestry, and aquatic products	6,721	8.5%
Total	78,980	100.0%

Source: DAF

Figure 2: DAF's procedure for funding appraisal and approvals



In general, the basic lending procedures at DAF are not very different from that of commercial banks and other credit organizations.

Collateral and Credit Risk

DAF-funded projects may use assets financed by loans as collateral. For Category A projects that cannot use such assets, DAF may refer to the Prime Minister (or other designated body) for a decision.

The procedure for dealing with credit risk is prescribed in Circular 89/2004/TT-BTC (September 2004), with four measures available: (1) extension of the loan, (2) unpaid debts of SOEs may be left to wait for settlement (frozen debt), (3) exemption or reduction of interest payments, (4) debt cancellation (both the principal and the interest). The General Director of DAF and branch managers are authorized to provide a loan extension if it does not exceed a third of the original credit's tenor, and the new maturity date does not exceed the maximum credit term of the project. Otherwise, DAF must submit the issue to the Ministry of Finance for consideration. In case a project owner is not able to repay the loan, and no other arrangement can be reached, DAF has the right to liquidate the project's assets, so as to recover the loan. If such a liquidation process does not compensate DAF for all of the loan principal, its provisions for credit risk may be used to make up for the remaining loss.

The current provision for bad debt is 0.2% of the average outstanding value of loans and guarantees. This is an improvement on an earlier arrangement whereby provisioning for bad debt stipulated in Decree 43 was simply set at 2% of annual total interest received, regardless of the scale of outstanding loans. Even so, DAF's provision for bad debt is markedly lower than the figure required for commercial banks.

DAF's Performance based on the Three Branch Case Studies

The following commentary and analysis of the performance of the three DAF branches in HCM City, Binh Duong and Tien Giang provinces are based on conversations with the DAF branch managers at these three locations. In general, DAF's publicity and promotion to potential clients is uninspiring, to say the least. Of the three branches, only the HCM City branch issues a leaflet introducing its activities. The whole DAF system does not even have a basic website. The main approach to communicate to potential clients is through relevant provincial offices, such as the Department of Planning and Investment. DAF branches sometimes also contact commercial banks to look for potential customers, especially those eligible to receive post-investment interest subsidies.

Of the three branches studied, only the HCM City branch has so far performed the full range of permitted activities. The DAF branches in Binh Duong and Tien Giang have not yet conducted much in terms of on-lending for either entrusted funds or ODA projects. From its establishment until the end of 2004, total credit granted by the DAF branch in HCM City was approximately VND 24,100 bn, nearly 32.3 times the credit issued by the branch in Binh Duong (VND 420 bn), and nearly 60 times that of the DAF branch in Tien Giang (VND 412 bn). However, ODA on-lending made up a very large proportion of total credit issued by the DAF branch in HCM City (VND 14,762 bn, or 61.3%). In contrast, only one garment and textile project in Binh Duong had received an on-lent loan from an ODA project, and no project in Tien Giang had received such a loan from the local DAF branch.

The turnover of development investment credits at the DAF branch in HCM City, as at end-2004, was VND2,900 bn VND – 7.3 times higher than that of Binh Duong (VND 395.9 bn), and 8.5 times higher than that of Tien Giang (VND 345 bn). However, the ratio of development investment credits to total loans of the DAF branch in HCM City was only 12%, compared with about 19.5% in Binh Duong and 83.7% in Tien Giang. The turnover of export finance credits at the DAF branch in HCM City, for the three years of 2002, 2003 and 2004, was about VND2,700 bn. Export credits in Binh Duong were VND561.3 bn, and DAF Tien Giang provided just VND65 bn (across 31 projects) in export credits. Consequently, the ratio of export finance credit to total credit was about 11.2% for the DAF branch in HCM City, 15.8% for Tien Giang, and 27.6% for Binh Duong. The recipients of DAF's export finance credits in Binh Duong were mostly private companies.

The turnover of post-investment interest subsidies by the DAF branch in HCM City, as of end-2004, was VND68 bn, or just 0.3% total credit. The equivalent figures in Binh Duong were VND13.2 bn (0.7%), and VND1.7 bn (0.5%) in Tien Giang. By end-2004, the DAF branch in HCM City had undertaken on-lending of entrusted funds, of around VND3,670 bn, accounting for 15.2% of total turnover. The on-lending entrusted fund in Binh Duong took a large proportion of total loan value (VND1,020 bn, equivalent 50.1% of total loan value), and the funds were allocated from a temporarily idle source within the provincial budget. The tenors of most loans are short-term.

Sadly, there is no data in the public domain that allows us to provide a profile of the kinds of companies or business sectors that have been the principal recipients of DAF financial assistance, nor give a breakdown of the precise kinds of funding that they have received.

However, with regard to state development credits, the ratio of SOEs at the DAF branch in HCM City was believed to be quite high, 77% in Tien Giang, and only 18.7% in Binh Duong. In terms of loan defaults, the DAF branch in HCM City reported just one bad debt of VND3.72 bn, in the form of an export finance credit. The ratio of bad loans to total outstanding loans in Tien Giang was said to be 3.2%, and nil in Binh Duong.

Table 7: Operating Results of the Three DAF's Branches

	HCM City		Binh Duong		Tien Giang	
	December 2004	**%**	**December 2004**	**%**	**December 2004**	**%**
1. Mid- to long-term loans (the Government Credits for Investment and Development						
Total loans (billion VND)	2,900	12.0	395.9	19.5	345	83.7
Projects-recipient	120		32		52	
Proportion of SOEs	n/a biggest		6	18.7	77%	
Proportion of Non-SOEs	n/a (quite a few)		26	81.3	23%	
Bad debts	0.0		0.0			3.2%
2. Short-term export finance credit						
Total loans (billion VND)	2,700	11.2	561.3	27.6	65	15.8
Projects-recipient					31 loans	
Proportion of SOEs	n/a		few		n/a	
Proportion of Non-SOEs	n/a (quite a lot)		quite a lot		n/a	
Bad debts	3.72					
3. Post-investment interest subsidies						
Total loans (billion VND)	66-68	0.3	13.2	0.7	1.7	0.5
Projects-recipient						
Proportion of SOEs	n/a		n/a			
Proportion of Non-SOEs	n/a (quite a lot)		n/a			
Bad debts	0.0					

	HCM City		Binh Duong		Tien Giang	
	December 2004	**%**	**December 2004**	**%**	**December 2004**	**%**
4. Guarantee						
Total loans (billion VND)	0.0		0.0	0.0	0.0	0.0
Projects-recipient						
Proportion of SOEs						
Proportion of Non-SOEs						
Bad debts	0.0					
5. On-lending of ODA						
Total loans (billion VND)	14,762	61.3	43.5	2.1	0.0	0.0
Projects-recipient	40		1			
Proportion of SOEs	n/a		1	100		
Proportion of Non-SOEs	n/a		0	0		
Bad debts	0.0					
6. On-lending of entrust funds						
Total loans (billion VND)	3,670	15.2	1,020	50.1	0.0	0.0
Projects-recipient	900					
Proportion of SOEs	n/a					
Proportion of Non-SOEs	n/a					
Bad debts	0.0					
7. Lending within the Vietnamese Government Agreements	0.0		0.0		0.0	0.0
Estimated Total Credit Turnover (Bn Dongs)	24,100	100	2033.9	100	412	100

Source: from discussion with DAF branches' managers

At the DAF branch in HCM City, there are 60 professional operating officers amongst a total of 82 staff, accounting for 73% of personnel. The corresponding ratio at the DAF branch in Binh Duong is 68% (19 operating staff out of 28 employees) and 83% (18 operating staff out of 22) at the DAF branch in Tien Giang province. In Binh Duong, the DAF branch manager is also the General Manager of the provincial fund for investment and development (ie. Binh Duong PAF). Most of the key operating staff have some experience in credit and banking. New employees are recruited like other state officials, and are trained under a common program designed by DAF headquarters. Loan issuance quotas are set for each operating staff in the DAF branches: VND400 bn per staff member for HCM City; VND35 bn in Binh Duong; and VND22.9bn for Tien Giang.

Table 8: DAF Branches Employees

	HCM City	Binh Duong	Tien Giang
Total Employees	82	28	20
Operating Employees	60	19	18
Ratio Operating/Total Employees	73%	68%	83%
Credit Turnover per employee (bln)	400	72.6	22.9

All of the operating capital of the DAF branch in Tien Giang is allocated by DAF headquarters, and this branch has not sought to mobilize additional capital locally. In 2004, the DAF branch in HCM City received total capital of VND5,438 bn, of which: VND1,852 bn (34%) was transferred from DAF headquarters; VND 2,186 bn (40.2%) stemmed from loan recovery and funds mobilized locally; and VND1,400 bn (25.8%) was assigned from entrusted funds. As at end-2004, the DAF branch in Binh Duong received total funds of VND746 bn, of which VND 284.4 bn (38.1%) was from DAF headquarters; VND36.6 bn (4.9%) was assigned from other institutions; VND117.4 bn (15.7%) from retained loan recovery; and VND 307.6 bn (41.3%) was mobilized locally. In 2004, the largest source of funds for the DAF branch in Binh Duong came from "retained loan recovery and capital mobilized locally", amounting to VND 164.3 bn (83.4%), of which three quarters was mobilized locally.

The most obvious feature in the operation of three branches is the large difference in the size of funds, and the range of activities, between the HCM City branch and the other two provincial branches. The most developed location (HCM City) has received the largest amount of subsidy credit, but the proportion of investment development credit (mid and long-term loan) is the lowest. The reported bad debt figures are surprisingly small, given the risky nature of projects eligible for DAF's subsidy credit.

Case Study of the PAFs in HCM City, Tien Giang and Binh Duong

Overview of their legal status and major functions

At present, there are 13 PAFs among Vietnam's 64 provinces. PAF is an experimental model of a state-owned finance company with the defined purpose to crease the range of financial instruments and mobilize capital for the development of provinces, and to "lift" a part of the investment burden from the State to the public. Most PAFs were established, and are controlled by, by the relevant Provincial People's Committee.

The first "experimental" model of a PAF was the Ho Chi Minh City Investment Fund for Urban Development (HIFU). The principal functions of HIFU are to mobilize capital, conduct investment and consulting activities. More specifically, in terms of mobilizing capital, HIFU is to:

- Mobilize medium- and long term capital from domestic organizations and individuals, to invest in and lend to projects;
- Mobilize and borrow from foreign organizations and individuals, in accordance with current regulations;
- Receive donations and support from domestic as well as foreign individuals and organizations.

Table 9: Capital Mobilization

Sources (in VND bn)	HCM City Branch	Binh Duong Branch		Tien Giang Branch
	In 2004	Until Dec 004	In 2004	In 2004
Credit capital from DAF headquarters	1,852	284.4	18.4	All allocated by DAF headquarters
Retained loan recovery and capital mobilized locally	2,186.1	425.0	164.3	0.0
Assigned capital (trusted funds) from other institutions	1,400	36.6	14.2	0.0
Total	**5,438**	**746.0**	**196.9**	**n/a**

In terms of investment activity, HIFU has a mandate to:

- Invest in socio-economic infrastructure development projects, economic development projects of HCM City, and projects relating to public welfare.
- Make direct and indirect investments through: i) establishing joint-ventures; ii) participating in the capital and securities market; and iii) project financing.

And in terms of consulting activity, HIFU may provide an investment consulting service, and manage trust funds from foreign and domestic organizations and individuals.

Adapted from HIFU, 12 other provincial assistance development funds have subsequently been established, among them being the PAFs in Binh Duong and Tien Giang provinces.

The Development Investment Fund of Binh Duong Province (hereafter the Binh Duong PAF) was established by Decision 63/1999/QĐ-UB of the People's Committee of Binh Duong, in May 1999. This is a state-owned financial organization, under the direct administrative control of the People's Committee of Binh Duong province, and under the professional management of relevant government agencies located in the province.

The primary functions of Binh Duong PAF comprise the following:

- mobilize idle medium- and long-term financial resources from all economic fields; receive funds granted from the State budget for development investments, and subsidised loans, for specific projects intended to foster socio-economic development in the province, in compliance with the direction of the People's Committee of Binh Duong province;
- invest in target projects of Binh Duong province, such as: transformation of production, business expansion, enhancement of trade and production capability, investment in production lines, technology renewals, business and product diversification, environmental improvement, etc.;
- participate in equitization programs of SOEs, and production plant re-location in select areas within the province;
- project-based loans;
- co-operate with other financial institutions, in forms of trust investments and syndicated investments;
- provide professional consultancy for domestic and foreign investments;
- participate in capital market activities, pursuant to regulations.

Tien Giang's PAF is a state-owned financial institution, directly managed by Tien Giang People's Committee. The PAF was established by the People's Committee's official document 21/2001/QD-UB, of June 2001. Tien Giang PAF aims to use both its charter capital and other mobilised funds to either directly invest in, or give loans to, eligible projects related to the economic development of Tien Giang province. More specifically, Tien Giang PAF's activities are defined as follows:

- Give loans to assist projects that are part of the main socio-economic development programmes in the region, including urban development, development of the eastern districts of Tien Giang, development of the aquatic industry, etc.
- Give loans to specific projects in collaboration with other commercial banks.
- Manage trust loans assigned by Tien Giang People's Committee, to support social projects, the equitization of SOEs, and the development of cooperatives.

Looking ahead, Tien Giang PAF aims to expand its direct investment activities.

The organisational structure of the PAFs tend to broadly follow the DAF organisational model, typically comprising a management board (consisting of 5 persons), a supervision division (of 1-3 persons), and a functional division that consists of a professional unit. In general, the primary functions of the three PAFs in Ho Chi Minh City, Binh Duong and Tien Giang are also broadly similar. However, HIFU is larger in scope for most functions, such as mobilizing capital and in terms of investment activity.

Capital Sources of the PAFs

The principal capital sources for each PAF are three-fold:

(1) Legal (charter) capital, usually sourced from the local provincial budget;

(2) Mobilized capital, typically sourced from: medium- and long-term loans from domestic and international credit agencies; Trust funds; and loans from the relevant Province/City People's Committee;

(3) Syndicated loans and others.

Also see table 10 below.

Table 10: PAF's Source of Funds, as at End-2004

No	Source	HCM City		Binh Duong		Tien Giang	
		Amount (VND bn)	Percentage (%)	Amount (VND bn)	Percentage (%)	Amount (VND bn)	Percentage (%)
1	Legal (charter) capital	687	23.8	138.67	17.85	82.3	72.32
	Budget contribution	457	15.8	110	14.16	82	72.05
	Additional	230	8.0	28.66	3.69	0.3	0.27
2	Mobilized capital	2,202	76.2	638.40	82.15	31.539	27.68
	Mid-term & long-term borrowing	458	15.8				
	Trust funds	857	29.7	68.4	73.35		
	Borrowed under authorization of Province/ City People's Committee	492	17.0	570.00	8.8		
3	Sourced from syndicated loans	343	11.9				
4	Other	52	1.8				
	Total	**2,889**	**100**	**777.07**	**100**	**113.8**	**100**

Source: HIFU, PAF Binh Duong, and PAF Tien Giang (8/2005)

The capital size of HIFU is four times higher than that of Binh Duong's PAF and over 25 times greater than that of Tien Giang PAF. The legal (chartered) capital of Tien Giang PAF accounts for 72.05% of its total capital, compared with 23.8 % for HIFU and 17.85% for Binh Duong's PAF. Mobilized capital accounts for the largest proportion of funds sourced by HIFU and Binh Duong's PAF. Most of these mobilized funds come from sources with subsidised interest rates. This cheap source of funding allows the PAFs to lend at a subsidised interest rates, thereby giving them an advantage over commercial banks.

PAF's Activities

The products and services of the PAFs are profiled in table 11.

Table 11: The Products and Services of the Three PAFs

The products and services of HIFU	The products and services of PAF Binh Duong	The products and services of PAF Tien Giang
Lending activities: *Lending kind:* HIFU provides credit incentives only in form of medium and long-term loan (from 12 month to 10 years); The enterprises were approved by people's committee of HCMC to invest in projects under "demand stimulating" program or "prior goods of the city" program receive subsidy directly from local budget to pay interest for lenders about 3%-5%.; HIFU can lend 100% of the project. The targeted projects of HIFU are projects that contribute to economic, social infrastructure and key-industry development in HCM City area such as: the demand stimulating program, the program to support prior products of HCMC (providing to the enterprises producing the prior products of HCMC in form of medium and long-term loan to expand their production); *Interest rate:* The lending interest rate of HIFU is defined by People Committee of HCMC. HIFU's lending rate for these projects is lower than that of commercial banks about 2% per year; *Amount of loan:* the maximum loan amount for a project does not exceed 70% of total investment in fixed assets of that project and does not exceed 15% of charter capital of HIFU; **Investment activities:** Beside lending activities, HIFU does make direct and indirect investments: *Direct Investment:* HIFU participates in projects as a shareholder of that project or company. The capital contributed bi HIFU plays a role of "enticement";	**Lending activities:** *Subjects to be served and the Fund's conditions for offering loans:* Pursuant to prevailing regulations, the Fund are targeting to serve the projects not dedicated to be granted capital from state budget, and not allowed to get the state credit for developing investment purposes, include: (1) Strategic investment projects with the aims for socio-economic development, economic structure transformation, enhancement of budget incomings in areas of the province; (2) Projects for developing the province's infrastructure of technology, economy and society; (3) Already-established enterprises in the province should be invested for expansion, newly-established should engage in the government's encouraged businesses and/or industries. All enterprises located in areas of the province should create jobs, join state-owned enterprise equitization programs and programs of production plant relocation; (4) Several other subjects have been submitted by The Fund's Management Board to The Provincial People's Committee for approval. *Loan interest rate:* loan interest rate offered by the Fund is regulated by the People's Committee, upon the suggestion of the management board of the Fund, but should not exceed the prevailing floor interest rate, as stipulated by the government. As different from commercial bank, the loan interest rate that the Fund offers to a	**Lending activities:** *Types of projects receiving loans:* - gives loans to projects of constructing infrastructure, upgrading and improving equipment and machinery, expanding production and business scale, production of exported goods and substitutes, cultivating aquatic products, developing small-scale industry and socialized projects in health care and education; - gives loans to projects which are financed by state budget but are not able to receive the assigned funds due to the lack of sources; - gives loans assigned by Tien Giang People's Committee: provides capital in advance for construction medium-voltage electric projects, credit for poor households, credit for assisting the development of co-operatives; - gives trust current funds to enterprises. *Loan maturity:* the majority of projects are given short-term and medium-term loans. Loan maturity is from one to five years. Loan maturity should not exceed 5 years for one project; *Lending interest rates:* lending at preferential interest rates of 3%, 5%, 5,4%, 6% based on Provincial People's Committee's stipulations or on the requests of the PAF management board for different types of projects in different time; *Loan amounts:* loan amount should not exceed 70% of guarantee assets' value for loan security.

Indirect (Portfolio Investment): investing in listed stocks or stock of "equitized" SOE; **Other activities:** Disbursement and collecting money from trust fund of HCMC People Committee and other sources; Management of state share in equitized SOEs; Consulting services: investment and capital arrangement service.	specific plan or project is set at the start of a credit contract and kept fixed during the lending period. Although loan interest rate offered at the Fund has been changing annually, it is always lower than interest rate quoted at commercial banks; currently interest rate offered at the Fund is 0.75% monthly; *Lending period:* Short-term loans: up to 12 months; *Medium or long-term credits:* lending period is indicated suitably with capital pay-back period of an investment project, credit-worthiness of loan holders and the nature of lending sources of the fund; **Direct investment:** Direct investment activities have been deployed since year 2001.	

Table 12: Performance of the Three PAFs, as at end-2004 and June 2005

No	Activities	HIFU (31/12/04)		Binh Duong (6/2005)		Tien Giang (6/2005)	
		Amount (VND bn)	(%)	Amount (VND bn)	(%)	Amount (VND bn)	(%)
1	**Lending**	**1,935**	**57.14**	**751,6**	**80.67**	**89**	**77.4**
1.1	Medium and long term lending	1,935	57.14	232.77	25.01	89	77.4
1.2	Short term lending			518.83	55.66		
2	**Investment**	**157**	**4.64**	**111.6**	**11.98**		
2.1	Direct investment	87.2	2.57	111.6	11.98		
2.2	Indirect Investment	67.7	2.00				
2.3	Other long term investment	2.1	0.07				
3	**Trust Fund management**	**1,294.5**	**38.22**	**68.4**	**7.34**	**26**	**22.6**
4	**Investment consultancy**			**0.0541**	**0.01**		
5	**Total**	**3,386.5**	**100.00**	**931.6541**	**100.00**	**115**	**100.00**

Source: HIFU, Tax Department of HCM City in 2004, PAF Bình Duong, and PAF Tien Giang (8/2005)

Table 13: Lending Value by Groups of Projects, as at end-2004 and June 2005

	HIFU		PAF Bình Duong		PAF Tien Giang	
	Value (bn dongs), Number of projects	Proportion (%)	Value (bn dongs), Number of projects	Proportion (%)	Value (bn dongs), Number of projects	Proportion (%)
Lending value (VND bn)	**2,968.72**		**751.6**		**115**	
Lending value by groups of projects						
Total number of projects	*170*	*100,00*	*43*	*100,00*	*48 projects for 27 firms*	*100,00*
Including:						
- Projects belonging to state-owned enterprises	*153*	*90*	*13*	*30.23*	*24*	*88.89*
- Projects belonging to private enterprises	*17*	*10*	*30*	*69.77*	*3*	*11.11*

Source: HIFU, Tax Department of HCMC in 2004, PAF Bình Duong and PAF Tien Giang (8/2005)

Lending Performance. Since its establishment, HIFU has provided credit for total of 170 projects, primarily in transportation infrastructure, clean water, urban and industrial development, education and health services. The total value of granted loans is VND 3,576.84 bn. During its first five years of operation, Binh Duong PAF's total turnover for both investments and credits was VND 751.6 bn, comprising: investment, medium- and long-term loans of VND 232.77 bn, and short-term loans of VND 518.83 bn. Binh Duong PAF has also been mandated by the People's Committee of Binh Duong province to manage trust funds pertaining to the BOT renovation project for highway No. 13. The total loan amount of PAF Tien Giang, as of July 2005, was VND 115 bn, with short- and medium-term lending amount accounting for VND 89 bn. In addition, Tien Giang PAF is currently managing some 'trust lending' for social programmes and poor households, valued at VND 10 bn, as well as for a medium-voltage electricity project, valued at VND 16 bn. This 'trust lending' accounts for 22.6% of the PAF's loan portfolio.

Customers. According to data on HIFU's outstanding loans, as at end-March 2005, projects belonging to SOEs account for about 90% of 106 projects under the "Demand Stimulating Program", and about 93% of projects receiving loans from the trust fund account. In general, small and medium sized enterprises are rarely beneficiaries of HIFU's lending, as they are not usually of a scale capable to carry out large infrastructure projects. Binh Duong PAF currently has 43 lending projects, including 7 in infrastructure system, 2 in residential zone development, 4 in school building and public health development, 2 in civil transportation, 3 in farming, 5 in exports, 4 in tourism, 4 in textiles and garments, 4 in construction materials, and 8 in various other sectors. Among these 43 projects, private enterprises account for 69.8% and SOEs for the remaining 30.2%. Just over half of the projects belong to small or medium sized enterprises. Since its establishment, Tien Giang PAF has completed 62 loans, and disbursed a further VND 119 bn to 33 active projects. More SOEs have been recipients of PAF loans than private enterprises – 24 and 3 respectively – with some firms the recipient of more than one loan. At present, Tien Giang PAF has 48 lending projects, spanning 37 investors and 27 enterprises, of which: two are limited liability companies, one is a privately-held enterprise, nine are equitized former state enterprises, and 15 are SOEs.

Direct Investments. At present, only HIFU and Binh Duong PAF have made direct investments. Among HIFU's direct investments is CII (Company for Infrastructure Investment), established in December 2001, with charter capital of VND 500 bn. HIFU is a founding shareholder, with a 15% stake in the firm. CII has raised additional capital by issuing shares to the public, and has won the right to collect fees on two major highways leading to the city: Hung Vuong Street and Dien Bien Phu Street. As for Binh Duong PAF, as at end-2004, it had invested in three projects, including a 19.2 hectare residential zone development in the province, using total capital of VND 111.6 bn. Two of the projects are being implemented by the PAF alone, and one as a joint venture project.

Indirect Investments. Up to now, only HIFU has made any indirect investments. Currently, HIFU has been a shareholder (and has a seat on the Board of Directors) of Housing Development Joint-Stock Bank since 1998, and Viet A Commercial Joint Stock Bank since 2002. HIFU has also bought shares in several companies, such as SACOM, Bach Tuyet Cotton Company, Vinamilk, and Phu Nhuan Jewellery Company, at the time that these companies were equitized. (The total investment was about VND 36 bn.) HIFU has also been mandated to manage shares in REE that are held by HCM City People's Committee.

EMPIRICAL FINDINGS: PART TWO

Sample Profile

As noted earlier, three locations were identified to serve as a sample for this study. The three locations were:

- Ho Chi Minh City – a major hub of economic and corporate sector activity;
- Binh Duong province – a rapidly growing province, abutting Ho Chi Minh City; and
- Tien Giang province – a province of comparatively lower economic and corporate sector development, located in the Mekong Delta, to the south of Ho Chi Minh City.

The total sample size was 230 companies, with 50% (115) firms receiving subsidized credit, and another 50% (115) eligible to receive such credit, but not currently doing so. The number of sample firms selected at each of the three locations was congruent with the relative size of the corporate sector (as measured by company registrations) in these locations. Therefore, HCM City hosted 170 companies selected for interviewing, of which 85 are clients of either DAF for HIFU, and 85 firms that are not receiving credit incentives.

The different types of companies, by legal form, are depicted in table 14.

In Tien Giang, among 20 companies interviewed, 5 were SOEs, 4 were equitised former SOEs, and 11 companies were privately-owned (5 limited liability firms, 3 joint-stock firms and 3 private companies). Amongst the ten companies to have received subsidized loans, 5 were state-owned and 3 were equitised former SOEs, whereas only two private firms (1 limited liability and 1 private company) had received subsidized loans. Conversely, the proportion of private companies that were eligible, but had not received subsidized credit, was high, at 90% (ie. 9 out of 10 companies surveyed).

In Binh Duong province, among the 40 eligible companies surveyed, 29 firms belonged to the private sector (19 limited liability firms, 3 joint-stock firms and 7 privately-owned companies), accounting for 72.5% of this sub-sample. Of these 19 firms, 13 had received subsidized loans (9 limited liability firms, 1 joint-stock firm and 3 privately-owned companies). The other firms receiving subsidised loans consisted of 7 state-owned enterprises. The proportion of eligible private sector firms which have not received subsidised loans is also high in Binh Duong, at 80% (comprising 10 limited liability firms, 2 joint-stock firms and 4 privately-owned companies). Conversely, the proportion of state-owned and equitised former SOEs account for only 20% of those eligible enterprises (1 equitised company and 3 state-owned enterprises) that had not received a subsidised loan.

In Ho Chi Minh City, limited liability firms, joint-stock firms and private-owned companies accounted for just over 72% of all the firms surveyed (ie. 123 firms, of which 93 were limited liability firms, 21 joint-stock firms and 9 privately-owned companies). State-owned enterprises and equitised former SOEs accounted for the remaining 28% of surveyed firms (comprising 38 SOEs and 9 equitised companies). Among those companies receiving subsidized credit, 46 (or 54%) belonged to the private sector (31 limited liability firms, 12 joint-stock firms and 3 private-owned companies). On the other hand, the ratio of SOEs and equitised former SOEs receiving subsidised loans was 46% (30 SOEs and 9 equitised firms). Among the 85 firms not receiving subsidized credit, 77 (91%) were from the private sector (comprising 62 limited liability firms, 9 joint-stock and 6 privately-owned companies), compared to just 8 SOEs (9%).

Table 14: Types of Companies, by Legal Form

Company Type		Tien Giang		Binh Duong		HCM City		Total Sample	
		No.	%	No.	%	No.	%	No.	%
Total number		20		40		170		230	
Number of companies receiving subsidized credit		10		20		85		115	
Equitised former SOEs	Number	4	20.00	1	2.50	9	5.29	14	6.09
	Receiving subsidized credit	3	30.00	0	0.00	9	10.59	12	10.43
	Not receiving subsidized credit	1	10.00	1	5.00	0	0.00	2	1.74
SOEs	Number	5	25.00	10	25.00	38	22.35	53	23.04
	Receiving subsidized credit	5	50.00	7	35.00	30	35.29	42	36.52
	Not receiving subsidized credit	0	0.00	3	15.00	8	9.41	11	9.57
Limited liability firms	Number	5	25.00	19	47.50	93	54.71	117	50.87
	Receiving subsidized credit	1	10.00	9	45.00	31	36.47	41	35.65
	Not receiving subsidized credit	4	40.00	10	50.00	62	72.94	76	66.09
Joint stock firms	Number	3	15.00	3	7.50	21	12.35	27	11.74
	Receiving subsidized credit	0	0.00	1	5.00	12	14.12	13	11.30
	Not receiving subsidized credit	3	30.00	2	10.00	9	10.59	14	12.17
Privately-owned companies	Number	3	15.00	7	17.50	9	5.29	19	8.26
	Receiving subsidized credit	1	10.00	3	15.00	3	3.53	7	6.09
	Not receiving subsidized credit	2	20.00	4	20.00	6	7.06	12	10.43

Across the total sample of all three provinces, 163 firms belonged to the private sector (comprising 117 limited liability firms, 27 joint-stock and 19 privately-owned companies), representing 71% of the total sample. SOEs and equitised former SOEs accounted for the remaining 29% of the sample (comprising 53 state-owned and 14 equitised firms). Out of the 115 companies receiving subsidized loans, 61 of them (or 53%) belonged to the private sector (ie. 41 limited liability firms, 13 joint-stock and 7 privately-owned companies). On the other hand, SOEs and equitised former SOEs accounted for 47%. Of the 115 companies not receiving subsidized loans, 102 (89%) were from the private sector (76 limited liability firms, 14 joint-stock and 12 privately-owned companies), and just 11% were SOEs or equitised former SOEs. It therefore appears that SOEs and equitised firms appear to enjoy better access to subsidized loans than their private sector peers.

Firms in the sample spanned almost all business sectors. The largest sector -- the garment, leather and shoe industry, with 40 companies -- accounted for just over 17% of the sample. Within the sub-sample of firms receiving subsidised loans, this industry accounted for 13% of firms. The next largest was the machinery, equipment and materials production sector, with 32 companies surveyed. This sector had the highest proportion of companies receiving subsidized credit (20 companies, or 17.4% of all firms receiving such loans). Other sectors with a relatively substantial proportion of firms receiving subsidised loans included: health and education (11.3%), building and building materials (8.7%), and chemistry, plastics and cosmetics (8.7%). See table 15 for details.

Table 15: Characteristics of the Sample, by Business Sector

Business areas		Tien Giang		Binh Duong		HCM City		Total	
			%		%		%		%
Number		20		40		170		230	
Number of firms receiving subsidized credit		10		20		85		115	
Agriculture	Total	4	20.00	4	10.00	20	11.76	28	12.17
	Firms receiving subsidized credit	0	0.00	1	5.00	14	16.47	15	13.04
	Firms not receiving such credit	4	40.00	3	15.00	6	7.06	13	11.30
Food and beverages	Total	0	0.00	3	7.50	6	3.53	9	3.91
	Firms receiving subsidized credit	0	0.00	2	10.00	2	2.35	4	3.48
	Firms not receiving such credit	0	0.00	1	5.00	4	4.71	5	4.35
Tourism, restaurants and hotels	Total	1	5.00	1	2.50	1	0.59	3	1.30
	Firms receiving subsidized credit	1	10.00	1	5.00	0	0.00	2	1.74
	Firms not receiving such credit	0	0.00	0	0.00	1	1.18	1	0.87
Garments, leather and shoes	Total	2	10.00	5	12.50	33	19.41	40	17.39
	Firms receiving subsidized credit	1	10.00	2	10.00	12	14.12	15	13.04
	Firms not receiving such credit	1	10.00	3	15.00	21	24.71	25	21.74
Wood, handicraft, fine arts, interior design	Total	1	5.00	6	15.00	15	8.82	22	9.57
	Firms receiving subsidized credit	0	0.00	3	15.00	5	5.88	8	6.96
	Firms not receiving such credit	1	10.00	3	15.00	10	11.76	14	12.17
Pharmacy, cosmetics, chemicals, plastics.	Total	1	5.00	4	10.00	19	11.18	24	10.43
	Firms receiving subsidized credit	0	0.00	2	10.00	8	9.41	10	8.70
	Firms not receiving such credit	1	10.00	2	10.00	11	12.94	14	12.17

Business areas		Tien Giang		Binh Duong		HCMC		Total	
			%		%		%		%
Total		20		40		170		230	
Number of firms receiving subsidized credit		10		20		85		115	
Transportation, consignment, exchange	Total	1	5.00	1	2.50	5	2.94	7	3.04
	Firms receiving subsidized credit	1	10.00	1	5.00	5	5.88	7	6.09
	Firms not receiving subsidized credit	0	0.00	0	0.00	0	0.00	0	0.00
Printing, packaging, advertisement	Total	1	5.00	1	2.50	14	8.24	16	6.96
	Firms receiving subsidized credit	1	10.00	0	0.00	6	7.06	7	6.09
	Firms not receiving subsidized credit	0	0.00	1	5.00	8	9.41	9	7.83
Information technology and telecoms.	Total	0	0.00	1	2.50	3	1.76	4	1.74
	Firms receiving subsidized credit	0	0.00	0	0.00	2	2.35	2	1.74
	Firms not receiving subsidized credit	0	0.00	1	5.00	1	1.18	2	1.74
Electrical, electronics, refrigeration	Total	0	0.00	2	5.00	5	2.94	7	3.04
	Firms receiving subsidized credit	0	0.00	0	0.00	2	2.35	2	1.74
	Firms not receiving subsidized credit	0	0.00	2	10.00	3	3.53	5	4.35
Machinery, equipment, Materials production	Total	6	30.00	1	2.50	25	14.71	32	13.91
	Firms receiving subsidized credit	3	30.00	0	0.00	17	20.00	20	17.39
	Firms not receiving subsidized credit	3	30.00	1	5.00	8	9.41	12	10.43
Building and building materials	Total	2	10.00	6	15.00	13	7.65	21	9.13
	Firms receiving subsidized credit	2	20.00	3	15.00	5	5.88	10	8.70
	Firms not receiving subsidized credit	0	0.00	3	15.00	8	9.41	11	9.57
Other areas (health, education, public interest services)	Total	1	5.00	5	12.50	11	6.47	17	7.39
	Firms receiving subsidized credit	1	10.00	5	25.00	7	8.24	13	11.30
	Firms not receiving subsidized credit	0	0.00	0	0.00	4	4.71	4	3.48

Table 16: Characteristics of the Sampled Firms, by Operating Capital (VND Bn)

Operating Capital	Tien Giang				Binh Duong				HCM City				Whole Sample			
	Max	Min	Ave.	%	Max	Min	Ave.	%	Max	Min	Ave.	%	Max	Min	Ave.	%
Total	98.0	0.6	20.83	100.00	300.0	0.8	63.32	100.00	600.0	0.9	58.36	100.00	600.0	0.6	55.96	100.00
Own capital	56.0	0.6	11.63	55.83	120.0	0.8	33.60	53.06	530.0	0.5	36.03	61.74	530.0	0.5	33.49	59.85
Borrowing capital	53.4	0.0	9.20	44.17	180.0	0.0	29.72	46.94	458.7	0.0	22.33	38.26	458.7	0.0	22.47	40.15
Total operating capital of firms with policy loans	61.5	4.0	24.13	100.00	300.0	3.0	59.56	100.00	600.0	1.7	105.01	100.00	600.0	1.7	89.99	100.00
Own capital of firms with policy loans	33.0	4.0	11.76	48.75	120.0	1.7	24.72	41.50	530.0	0.5	62.56	59.58	530.0	0.5	51.47	57.19
Borrowed capital of firms with policy loans	53.5	0.0	12.37	51.25	180.0	1.0	34.84	58.50	458.7	0.0	42.44	40.42	458.7	0.0	38.53	42.81
Total operating capital of firms without policy loans	98.0	0.6	17.86	100.00	290.0	0.8	67.07	100.00	330.0	0.9	15.05	100.00	330.0	0.6	24.04	100.00
Own capital of firms without policy loans	56.0	0.6	11.51	64.44	120.0	0.8	42.47	63.32	250.0	0.5	11.40	75.73	250.0	0.5	16.63	69.17
Borrowed capital of firms without policy loans	42.0	0.0	6.35	35.56	174.0	0.0	24.60	36.68	80.0	0.0	3.65	24.27	174.0	0.0	7.41	30.83

Company size was measured in terms of operating capital (also see table 16). The mean operating capital of firms in our sample was VND 55.96 bn. More specifically, the maximum operating capital was VND 600 bn, while the minimum was just VND 60 million. Companies in Binh Duong province had the largest average operating capital, of VND 63.32 bn. This compared with an average of VND 58.36 bn in HCM City, and just VND 20.83 bn in Tien Giang province.

On average, those firms receiving subsidized credit had operating capital that was 3.74 times larger than those without such loans. In HCM City, those firms receiving subsidised loans had a larger scale (a mean operating capital of VND 105 bn) than those in Binh Duong (VND 59.56 bn) and Tien Giang (VND 24.13 bn). Indeed, the average operating capital of those firms companies in HCM City receiving a subsidised loan is 7 times higher than that of firms not receiving (but technically eligible) for such loans. In contrast, in Binh Duong province, the sub-sample of firms not receiving subsidised loans had a higher average operating capital than those receiving such loans. Whereas in Tien Giang, companies receiving subsidised loans had an average operating capital that was just slightly higher than that of firms not receiving such loans.

Receiving an Investment Incentive Certificate and the Reality of Acquiring Credit Incentives

Across the whole 230 surveyed companies, 121 firms (or just under 53%) had an investment incentive certificate. Among the sub-sample of 115 firms that had gained access to subsidized credit, the large majority (102 companies) had this investment incentive certificate, while the remaining 13 (11%) firms did not. For the 115 firms without subsidised loans, just 19 of them (or 16.5% of the sub-sample) had been granted an investment incentive certificate, but had not subsequently received a subsidised loan.

In HCM City, 81 firms (or 48% of firms surveyed in the city) had the investment incentive certificate, of which 80 had subsequently attained subsidized loans. Indeed, they represented 94% of firms in the HCM City sub-sample to have acquired subsidised loans. The equivalent percentages for Binh Duong and Tien Giang were 80% and 60% respectively. In terms of HCM City companies surveyed that had not received subsidised credit, just one had an investment incentive certificate. In contrast, in Tien Giang, all 10 firms surveyed that had an investment incentive certificate had not subsequently gained access to subsidized loans. In Binh Duong, 40% of firms surveyed that had an investment incentive certificate had not subsequently gained access to subsidized loans.

Companies holding an investment incentive certificate, whether or not they had subsequently received a subsidised loan, mostly belong to the so-called 'List A' - a list of priority business sectors - or were eligible for some other reason (such as having a high proportion of export revenues, or manufacturing products deemed to be important, etc). Companies receiving the certificate under 'Lists B and C' (ie. geographic locations with difficult or very difficult socio-economic conditions) accounted for only about 5% of the total number of companies that had received an investment incentive certificate.[12] Among our 115 companies receiving subsidized credit, just 13 companies (or just 11%) did not have an investment incentive certificate. One reason why these 13 firms may have been eligible for subsidised loans, and yet not holding investment incentive certificates is that the loan pertained to export activity. See table 17 for further details.

12. Details of Lists A, B and C can be found in Decree 164 on corporate income tax

Table 17: Current Situation of Firms Receiving an Investment Incentive Certificate

Classification of Companies by Receipt of Loan Subsidy	Tien Giang		Binh Duong		HCM City		Full Sample	
		%		%		%		%
Total	20	8.70	40	17.39	170	73.91	230	100
Number of companies receiving subsidized credit	10	50.00	20	50.00	85	50.00	115	50.00
Number of companies not receiving subsidized credit	10	50.00	20	50.00	85	50.00	115	50.00
Number of companies having the investment incentive certificate	16	80.00	24	60.00	81	47.65	121	52.61
Number of companies having the certificate but not attaining subsidized credit	10	100	8	40.00	1	1.18	19	16.52
- Number of companies receiving subsidy accordingly to list 'A'	9	90.00	6	75.00	1	100	16	84.21
- Number of companies receiving subsidy accordingly to list 'B'	0	0.00	1	12.50	0	0.00	1	5.26
- Number of companies receiving subsidy accordingly to list 'C'	0	0.00	0	0.00	0	0.00	0	0.00
- Companies receiving subsidy because of other reasons	1	10.00	3	37.50	0	0.00	4	21.05
Companies having the investment incentive certificate and attaining subsidized credit	6	60.00	16	80.00	80	94.12	102	88.70
- Number of companies receiving subsidy accordingly to list 'A'	5	83.33	12	75.00	66	82.50	83	81.37
- Number of companies receiving subsidy accordingly to list 'B'	0	0.00	0	0.00	6	7.50	6	5.88
- Number of companies receiving subsidy accordingly to list 'C'	0	0.00	0	0.00	5	6.25	5	4.90
- Companies receiving subsidy because of other reasons	2	33.33	7	43.75	6	7.50	15	14.71

Issues and Practices of Firms not Receiving Subsidised Loans

Let us now turn our focus to the 115 firms in our sample that are technically eligible for a subsidised loan – largely as a function of holding an investment incentives certificate (or qualified for receiving corporate income tax incentive or credit preferential or both of these incentives) – but are not currently doing so. (Also see table 18) In an attempt to find out the reasons why these firms are not receiving preferential credit, the following questions were posed: (1) Does your firm think it is technically eligible for a subsidized loan from the local development assistance funds (either the local PAF or DAF branch)?; (2) If yes, has the firm ever applied for such a loan?, and if yes, what is the reason why it was not successful in attaining such a loan?, and if no, what is the reason why it has not considered applying for such a loan?; (3) If the local PAF / DAF branch approached the firm and offered to provide a subsidized loan, would the firm be potentially interested in taking such a loan?, and if no, please give the reason why the firm not interested in?; (4) Does the firm currently have any loans with a commercial bank?, If no, what are the main reasons why not?, and if yes, what are the basic terms of the commercial loan?; and (5) any overall comments regarding the level of difficulty/ease in approaching the local PAF / DAF branch for a subsidised loan, in comparison with loans obtained from a commercial bank.

Regarding question (1), 40% of surveyed firms located in Tien Giang province answered they were indeed eligible for a subsidised loan, and the remaining 60% were unsure of their eligibility. In Binh Duong province, the proportion of firms saying yes they were eligible was the same (40%), with 10% believing they were not eligible, and the remaining 50% unsure of their eligibility status. In HCM City, 29% of firms said they were eligible for such a loan, 16% thought they were not eligible, and 55% were unsure. Therefore across all three locations, it appears that 32% of firms not receiving subsidised loans believed they were eligible for such loans, 14% felt they were not eligible, and 59% were unsure of their eligibility status. This result suggests that the majority of firms are unclear on the criteria for receiving preferential credit, and further implies that the current credit preferential policy is not sufficiently understood by many Vietnamese firms. This finding is supported by the answers given to question 3 (If the local PAF / DAF branch approached your firm, and offered to provide a subsidized loan, would you be potentially interested?). The results show that 93% of all the surveyed firms answered in the affirmative: 100% in the case of Tien Giang firms, 95% of firms in Binh Duong province, and 90% of firms in HCM City.

Among those firms that believe they are eligible for subsidised loans, nearly 60% of them had applied but had not received any response so far, (64% in the case of HCM City, and 50% for Tien Giang and Binh Duong). The remaining 40% had not yet applied. The most common reasons why firms had not applied for such a loan are as follows:

(1) the application procedure is really complicated and bureaucratic, so they have not completed their loan application process. This answer accounted for 55% (primarily from firms located in HCM City);

(2) firms do not meet the requirements on collateral. This answer accounted for 5% (primarily from firms in Tien Giang province);

(3) firms had been informed by the PAF or DAF branch that they were not eligible for preferential credit. This answer accounted for 9% of firms (mostly from firms located in Binh Duong province);

(4) firms do not know why they have not received such a loan. This answer accounted for 31% (mostly from firms located in HCM City).

The reasons why some eligible firms had not applied for subsidised credit, despite a belief that they were eligible, was as follows:

(1) afraid of the difficult and complicated application procedure, and long cooling-off time, was cited by 40% of relevant companies;

(2) unclear about the application procedure was cited by 53%;

(3) aware that a high commission fee is entailed was cited by 7%.

An underlying trend emanating from these results is the concern about bureaucratic procedures and the time involved in applying for such a loan. Even the small proportion (8%) of firms that were simply not interested in preferential credit, even when the local PAF or DAF branched introduced the idea (mainly cited by firms located in HCM City), the reasons given for this disinterest mainly pertained to the complicated application procedure and high commission fees.

On the issue of the relative ease or difficulty of approaching the local PAF or DAF branch for a subsidized loan, almost all of the firms surveyed stated that it is much more difficult than applying for conventional loans from commercial banks. Almost all firms believe that the application procedure for preferential credit is bureaucratic and complicated, and to receive such loans within a decent period of time will require the payment of "unofficial" commission fees. This is exacerbated by the limited size of such loan funds, and the high competition between firms to obtain loans with a reduced interest rate, prompting the offer of unofficial commission fees to gain an advantage over other applicants. In addition to the bureaucracy issue, the survey results suggest that the policies in providing subsidised loans to eligible firms are not sufficiently transparent, nor disseminated in an optimal manner. Too many firms feel the application procedure is difficult in practice, the eligibility criteria tend to lack clarity, and that firms do not know enough about the preferential loan policy.

Table 18: Factors Influencing the Behaviour of Firms not Receiving Subsidised Credit

Business form of surveyed firms		Tien Giang		Binh Duong		HCM City		Full Sample	
		No	%	No	%	No	%	No	%
Number of firms not receiving preferential credit		10		20		85		115	
Awareness regarding their eligibility for subsidized loans from DAF/PAF under prevailing regulations	Yes	4	40.00	8	40.00	25	29.41	37	32.17
	No	0	0.00	2	10.00	14	16.47	16	13.91
	Not know	6	60.00	10	50.00	46	54.12	62	53.91
If yes, whether the firms have applied for preferential credit or not	Yes	2	50.00	4	50.00	16	64.00	22	59.46
	Not yet	2	50.00	4	50.0	9	36.00	15	40.54
Reasons why surveyed firms really "have applied" for preferential credit but have not yet obtained this policy loan	Application procedure is so difficult and complicated	1	50.00	2	50.00	2	12.50	5	22.73
	Firms have not completed the application procedure for credit preferential					7	43.75	7	31.82
	Firms do not meet requirements for pledges and mortgages	1	50.00					1	4.55
	Firms state not to be eligible for eligible for credit preferential			2	50.00			2	9.09
	Firms are unclear about their eligibility					7	43.75	7	31.82

Business form of surveyed firms		Tien Giang		Binh Duong		HCM City		Full sample	
		No	%	No	%	No	%	No	%
Reasons why firms currently "have not applied" for preferential credit, despite being eligible for this kind of incentive, as stipulated in prevailing regulations	Application procedure is so difficult and complicated; cooling-off period is really time-consuming	2	100.00	2	50.00	2	22.22	6	40.00
	Firms are not eligible for this incentive			2	50.00	3	33.33	5	33.33
	Firms do not know application procedure for credit preferential					3	33.33	3	20.00
	The commission fee is so high					1	11.11	1	6.67
Whether or not surveyed firms are interested in policy loans, if DAF/PAF deploy them	Yes	10	100.00	19	95.00	77	90.59	106	92.17
	No	0	0.00	1	5.00	8	9.41	9	7.83
Reasons why the surveyed firms are not interested in such loans	Firms are able to obtain loans from outside financial institutions					100.00	1	2	12.50
	The application procedure is too complicated				0	0.00	3	3	37.50
	Commission fees are rather high						4	6	50.00
Proportion of firms getting loans from commercial banks	Yes	6	60.00	18	90.00	76	89.41	100	86.96
	No	4	40.00	2	10.00	9	10.59	15	13.04
Reasons why surveyed firms do not borrow from commercial banks	Firms do not have need of such capital	3	75.00	2	100.00	8	88.89	13	86.67
	Loans have short duration and small size	1	25.00					1	6.67
	Firms are able to self-mobilize capital					1	11.11	1	6.67
Comments regarding difficulty / ease in obtaining loans from DAF/PAF, in comparison with commercial banks	Easier	0	0.00	0	0.00	6	7.06	6	5.22
	No comment	1	10.00	4	20.00	5	5.88	10	8.70
	More difficult	9	90.00	16	80.00	74	87.06	99	86.09

Table 19: Size of Conventional Bank Loans Held by Firms not Receiving Preferential Credit

	Max.			Min.			Average		
	Loan size (VND bn)	Duration (months)	Interest rate (%)	Loan size (VND bn)	Duration (months)	Interest rate (%)	Loan size (VND bn)	Duration (months)	Interest rate (%)
Tien Giang	30	60	1.10	0.5	4	0.85	13.783	18.6	0.96
Binh Duong	47.4	24	1.10	1.0	3	0.82	15.100	13.3	0.97
HCM City	21.76	60	1.20	0.2	3	0.65	2.715	23.4	0.92
Whole Sample	47.4	60	1.20	0.2	3	0.65	5.342	22.2	0.93

vAcross the 115 surveyed firms not receiving subsidised loans, 87% of them are currently accessing normal loans from commercial banks, with the remaining of 13% not accessing credit of this kind. The reason why the proportion of 13% of firms not borrowing loans in commercial banks is that most of them do not have outside financing need, and the remaining minority has self-mobilized from other financial sources.

The sizes of conventional loans provided to firms not receiving preferential credits is shown in the table 19 below. The average size of loan per firm was VND 5.34 bn, the average duration was 22 months, and the average interest rate was 0.93% per month. The biggest size of loan was VND 47.4 bn dong (held by a firm in Binh Duong province), and the smallest loan was VND 200 million (a firm in HCM City). The longest loan duration was 60 months, and the shortest was 3 months. The highest interest rate was 1.2% per month and the lowest was 0.65% per month.

In Table 20, the average ratio of debt over owners' equity, for firms not receiving subsidised loans, is 44.56% across all 155 surveyed firms, spanning a highest ratio of 57.92% (for a firm located in Binh Duong province) and a lowest of 33.18% (for a firm located in HCM City). All financial ratios indicate that borrowers of commercial banks have low potential risk.

Table 20: Ratio of Debt over Owner's Equity for those Firms not Receiving Subsidised Loans.

	Average total capital (VND bn)	Average owner's equity (VND bn)	Average debt (VND bn)	Ratio of debt / owner's equity (%)
Tien Giang	17.86	11.51	6.35	55.17
Binh Duong	67.07	42.47	24.60	57.92
HCM City	15.05	11.40	3.65	33.18
Whole Sample	24.04	16.63	7.41	44.56

Issues and Practices of Firms Receiving Subsidised Loans

Of the 115 surveyed firms that had received policy loans, nearly 55% had received preferential credits from the relevant provincial assistance fund (PAF), 42.5% have received preferential credits from the local DAF branch, and 2.5% had received preferential credits from other sources (eg. DAF branches in Hanoi or other provinces, where the head office of the enterprise is located). In Tien Giang and Binh Duong provinces, the larger proportion of firms received such loans from the provincial DAF branch, whilst enterprises in HCMC mostly received loans from the PAF (ie. HIFU).

Across the sample as a whole, enterprises receiving medium- and long-term credits accounted for the highest proportion of subsidised loans, at 62%. In Tien Giang and Binh Duong these proportions were as high as 90% and 87% respectively, with 52% in HCM City. Incentives in the form of 'interest subsidies after investment' accounted for 28% of the whole sample, with the highest figure in HCM City (at 36%). This form of credit accounted for less than 5% of enterprises in Tien Giang and Binh Duong provinces. Export credits across the whole sample accounted for roughly 10.6%, mainly channelled to firms in HCM City and Binh Duong province.

With respect to conditions attached to such loans, nearly 61% of all the relevant firms in the sample were eligible. Indeed, 95% of surveyed firms in Binh Duong were eligible, while the ratio of eligible firms in HCM City and Tien Giang province were 54% and 50% respectively. According to the surveyed firms, conditions attached to policy loans included: an approved feasibility study of the project receiving financing, collateral requirements, and approval by the relevant municipal or provincial People's Committee. However, more than 48% the surveyed firms said they did not meet the attached conditions. Nonetheless, the conditions attached to such policy loans were not seen as being much different from those stipulated by commercial banks for conventional loans, except in cases where specific projects needed to be approved by the relevant municipal or provincial People's Committee. Also see table 21.

Table 21: Issues and Practices Pertaining to Policy Loans

Type of Enterprises		Tien Giang		Binh Duong		HCM City		Full Sample	
		No	%	No	%	No	%	No	%
Number of enterprises received policy loans		10		20		85		115	
Enterprises receiving policy loans provided by DAF/PAFs	DAF	9	90.00	14	70.00	26	30.59	49	42.61
	PAF	1	10.00	6	30.00	56	65.88	63	54.78
	Other	0	0.00	0	0.00	3	3.53	3	2.61
Kind of loans offered	Mid-term and long-term credit	9	90.00	20	86.96	47	52.22	76	61.79
	Subsidized interest loan after invest-mint	1	10.00	1	4.35	32	35.56	34	27.64
	Export credit	0	0.00	2	8.70	11	11.11	13	10.57
	Other	0	0.00	0	0.00	0	0.00	0	0.00
Whether there are conditions attached to such loans	Yes	5	50.00	19	95.00	46	54.12	70	60.87
	No	5	50.00	1	5.00	38	44.71	44	38.26

Table 22: Policy Loans to 15 Sectors Cited in Decree 106

Type of Projects Eligible	Tien Giang		Binh Duong		HCM City		Full Sample	
	No.	%	No.	%	No.	%	No.	%
Number of firms to have received preferential credit	10		20		85		115	
Projects taking place in list B or C locations of Decree 51: to afforest for paper production, production of paper powder and MDF together with processing	0	0.00	0	0.00	2	2.47	2	1.77
Project of production original and new seeds, breeds using high technology	0	0.00	1	4.55	2	2.47	3	2.65
Clean water supply for living usage	0	0.00	1	4.55	2	2.47	3	2.65
Production of industrial salt	0	0.00	0	0.00	0	0.00	0	0.00
Production of antibiotics	0	0.00	0	0.00	0	0.00	0	0.00
Vocational Training schools in rural areas	0	0.00	0	0.00	0	0.00	0	0.00
Projects to build complete printing and dyeing factories	0	0.00	1	4.55	5	6.17	6	5.31
Alumni mining and producing, steel refining from ore, special steel production	0	0.00	0	0.00	4	4.94	4	3.54
Bus making with domestic inputs of more than 40%, locomotive making and assembling, railroad car making in domestic factories, ship building	0	0.00	0	0.00	3	3.70	3	2.65
Producing diesel engines with capacity larger than 300 CV	0	0.00	0	0.00	1	1.23	1	0.88
Production of new and heavy mechanical products, casting project of large scale	0	0.00	0	0.00	2	2.47	2	1.77
Large hydroelectric plant and domestic equipment making in areas cited in lists B and C of Decree 51	0	0.00	0	0.00	1	1.23	1	0.88
Production of nitrogenous fertilizers, DAP	0	0.00	0	0.00	0	0.00	0	0.00
To use as equity in projects borrowing ODA funds	0	0.00	1	4.55	0	0.00	1	0.88
Other	10	100.00	18	81.82	59	72.84	87	76.99

According to Decree 106/2004/ND-CP, an enterprise is eligible to be granted preferential credit when it operates in one of 15 preferential industries, cited in table 6.9, below. However, the survey found that few enterprises were qualified under the preferential industry criteria prescribed in Decree 106. The highest proportion of eligible enterprises was those to build complete printing and dyeing factories (5.3%), followed by enterprises investing in special steel production (3.5%). Only 2.65% of the 115 surveyed firms had projects using high technology. Projects for bus making with more than 40% of domestic inputs, locomotive making and assembling, railroad car making in domestic factories, and ship buildings accounted for less than 3%; and reforestation projects to supply materials for the paper industry accounted for less than 2%. With respect to other preferential industries cited in Decree 106, there was either no activity being conducted within our sample of 115 firms, or a few isolated projects that accounted for less than 1% of the full sample. Conversely, projects involved in activities cited in 'List A' of the Law on Corporate Income Tax accounted for nearly 77% of the firms receiving policy loans. These findings would suggest that the preferential loan policy has not been applied as one might have expected, since very few targeted projects have actually been granted subsidised loans.

When asked if they could get a loan of roughly the same size from a normal commercial bank, instead of from the local PAF or DAF branch, 56.5% of the 115 enterprises receiving a policy loan answered in the affirmative. In Tien Giang, the proportion of enterprises that thought they could get a similar commercial loan was highest at 70%, followed by enterprises in HCM City at 62.3%. Conversely, 28.7% of the full sample answered that they thought they could not get a similar loan from a commercial banks, of which the proportions for each location were 50% in Binh Duong, 30% in Tien Giang, and 23.5% in HCM City. (A small proportion of firms answered "do not know" to this question, ranging from 25% in Binh Duong to 10% in HCM City.)

The three main factors motivating firms to seek a loan from the local PAF or DAF branch, rather than from (or in addition to) a normal commercial bank were:

(1) lower interest rates, cited by 79% of our sample of 115 firms;

(2) lower collateral requirements, cited by just over 24%; and

(3) more attractive loan terms/conditions, cited by roughly 6%.

We then asked firms how easy it was to apply for loans from assistance funds. Just 11.3% of surveyed firms answered that it was "easy" (and these respondents were mostly located in HCM City). Just under 49% replied "neutral" (the proportion of firms responding so in Tien Giang was 60%, 49% in HCM City, and 40% in Binh Duong). Yet 39% of the full sample said it was "hard" to obtain policy loans, mainly because of bureaucratic procedures, although some of them (more than 13%) also attributed the difficulty to high service costs. See table 23.

In addition to policy loans from DAF and PAF, a fairly large proportion of these recipient firms also had loan agreements with commercial banks. Of the full sample of 115 firms, almost 76% were doing so, including 80% of firms in HCM City. The proportion for firms accessing both policy loans and commercial loans in Binh Duong was 65%, and 60% in Tien Giang. However, commercial bank loans were mostly short-term loans, often with maturities of just 3 to 4 months. The smaller proportion of surveyed firms that had been granted policy loans, but had not also taken out conventional loans from commercial banks, typically cited two reasons for this:

(1) more benefits could be derived from PAF or DAF loans (cited by almost 61%);

(2) higher rates of interest charged by commercial banks (39%).

When we asked firms whether it was easier or harder to obtain loans from DAF or PAF, compared to commercial banks, 43.5% of the full sample answered that it was "harder" (60% in Tien Giang, 45% in Binh Duong, and 41% in HCM City). A further 30% of the full sample perceived no major difference in the relative difficulty or ease of obtaining loans from assistance funds when compared with commercial banks with (cited by 50% in Binh Duong, 30% in Tien Giang, and 25% in HCM City). The firms attributed difficulties of obtaining policy loans mainly to the complicated procedures, including a complicated appraisal procedure, resulting in delayed loan disbursement. Another significant factor impeding firms from obtaining policy loans was the high service costs (cited by 20% of firms across the full sample of 115 recipients), with most of these firms located in HCM City. See table 24.

Table 23: Accessibility to Commercial Loans, Compared with Policy Loans

Type of Enterprise		Tien Giang		Binh Duong		HCM City		Full Sample	
		No.	%	No.	%	No.	%	No.	%
The number of enterprises that have received preferential loans		10		20		85		115	
Whether the enterprise could get a loan of roughly the same size from a normal commercial bank	Yes	7	70.00	5	25.00	53	62.35	65	56.52
	Do not know	0	0.00	5	25.00	9	10.59	14	12.17
	No	3	30.00	10	50.00	20	23.53	33	28.70
Main factors motivating the firm to get a loan from the PAF or DAF, rather than from (or in addition to) a normal bank	Lower interest rate	7	70.00	15	75.00	69	81.18	91	79.13
	Lower collateral requirement	3	30.00	11	55.00	14	16.47	28	24.35
	More attractive loan terms/conditions	0	0.00	7	35.00	0	0.00	7	6.09
	Other	0	0.00	1	5.00	4	4.71	5	4.35
Comment of enterprises on the difficulty of getting loans from PAF/DAF	Easy	0	0.00	0	0.00	13	15.29	13	11.30
	Neutral	6	60.00	8	40.00	42	49.41	56	48.70
	Hard	4	40.00	12	60.00	29	34.12	45	39.13
Why enterprises find it difficult to get loans from PAF/DAF	Complicated and time-consuming appraising procedure	2.	50	9	75.00	19	65.52	31	68.89
	Difficult to disburse	0	0.00	1	8.33	0	0.00	1	2.22
	Limited capital	1	25.00	1	8.33	0	0.00	2	4.44
	Restricted lending period	1	25.00	0	0.00	0	0.00	1	2.22
	Costly consultancy fees	0	0.00	1	8.33	6	20.69	6	13.33
	Easier to get loans from commercial banks	0	0.00	0	0.00	1	3.45	1	2.22
	Bureaucratic, unprofessional procedure	0	0.00	0	0.00	3	10.34	3	6.67

Table 24: Firms' Perceptions of the Relative Difficulty in Obtaining Policy Loans

Type of Enterprise		Tien Giang		Binh Duong		HCM City		Full Sample	
		No	%	No	%	No	%	No	%
The number of enterprises that have received preferential loans		10		20		85		115	
Whether the company currently have any loans with a commercial bank, in addition to PAF/DAF	Yes	6	60.00	13	65.00	68	80.00	87	75.65
	No	4	40.00	7	35.00	17	20.00	28	24.35
Reasons not to get loans from commercial banks									
High interest rates		2	50.00	3	42.86	6	35.29	11	39.29
Better DAF/PAF loan terms		2	50.00	4	57.14	11	64.71	17	60.71
Perception of enterprises on whether it is easier or harder to get a loan from the PAF/DAF than from a normal bank	Easier	1	10.00	1	5.00	20	23.53	22	19.13
	Neutral	3	30.00	10	50.00	21	24.71	34	29.57
	Harder	6	60.00	9	45.00	35	41.18	50	43.48
Reasons why it is harder:									
- The application is to submit to the provincial People's Committee for approval		2	33.33	0	0.00	0	0.00	2	4.00
- Loans are mainly targeted to strategic projects		1	16.67	0	0.00	1	2.86	2	4.00
- The firms must have a good track record		1	16.67	2	22.22	0	0.00	3	6.00
- Complicated and time-consuming application procedures		2	33.33	3	33.33	15	42.86	20	40.00
- It is hard and slow to get state loans		0	0.00	2	22.22	0	0.00	2	4.00
- Slow and tough appraisal process		0	0.00	2	22.22	6	17.14	8	16.00
- Costly intermediary fees		0	0.00	0	0.00	10	28.57	10	20.00
- More restrictive conditions in return for better terms		0	0.00	0	0.00	3	8.57	3	6.00

The average size of the DAF and PAF loans, as well as the loan terms and interest rates, are presented in table 25.

Table 25: Size and Terms of DAF and PAF Loans

	Max			Min			Average		
	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)
Tien Giang	10.4	72	0.70	1.2	6	0.30	4.828	55.3	0.47
Binh Duong	80	84	0.75	1	24	0.40	9.094	57.3	0.60
HCM City	150	144	0.90	0.3	6	0.00	32.084	55.2	0.48
Full Sample	150	144	0.90	0.3	6	0.00	26.008	55.6	0.50

Table 26: Size and Terms of Commercial Bank Loans Taken by Firms Receiving Policy Loans

	Max			Min			Average		
	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)
Tien Giang	22	12	0.92	0.75	4	0.65	8.527	6.8	0.85
Binh Duong	20	24	1.10	0.6	6	0.80	7.715	14.25	0.94
HCM City	101	60	1.25	0.15	1	0.67	21.999	7.5	0.91
Full Sample	101	60	1.25	0.15	1	0.65	19.173	8.2	0.91

Table 27: Size and Terms of Commercial Bank Loans Taken by Firms not Receiving Policy Loans

	Max			Min			Average		
	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)	Loan amount (VND bn)	Term of loan (months)	Interest rate (%)
Tien Giang	30	60	1.10	0.5	4	0.85	13.783	18.6	0.96
Binh Duong	47.4	24	1.10	1	3	0.82	15.100	13.3	0.97
HCM City	21.76	60	1.20	0.2	3	0.65	2.715	23.4	0.92
Full Sample	47.4	60	1.20	0.2	3	0.65	5.342	22.2	0.93

The average size and terms of the policy loan was significantly different across the three localities. The average policy loan borrowed by our surveyed firms in HCM City was VND 32.08 bn, ranging from VND 150 bn to just VND 0.3 bn. The corresponding figures for surveyed firms located in Binh Duong province were: VND 9.09 bn (average), VND 80 bn (largest), and VND 1 bn (smallest). In Tien Giang, the average, largest and smallest policy loans that firm borrowed were VND 4.8 bn, VND 10.04 bn, and VND 1.2 bn, respectively. The average loan tenor across the full sample was 55.6 months (more than 4.5 years), of which the longest was 144 months (12 years), and the shortest was 6 months. With regard to the rates of interest across the full sample of 115 firms receiving such subsidised loans, the mean, maximum and minimum monthly rates were: 0.5%, 0.9% and 0% respectively. The average rates of interest were not significantly different for firms located in HCM City and Tien Giang (ie. 0.48% and 0.47% per month respectively), but markedly higher for firms located in Binh Duong, at 0.6% per month.

Table 26 shows the average size and terms of commercial loans taken out by firms also receiving policy loans. Over the whole sample, the average size of commercial loan borrowed by the 115 firms also receiving preferential credits was VND 19.17 bn. The average size of a commercial loan was largest among firms located in HCM City (at nearly VND 22 bn), when compared with Tien Giang (VND 8.53 bn) and Binh Duong (VND 7.72 bn). However, the loan tenor was longest in Binh Duong (14.25 months on average), while the average loan tenor for HCM City firms that we surveyed was 7.5 months, and just 6.8 months for firms in Tien Giang. Across the full sample, the average credit tenor was 8.2 months, ranging from a maximum term of 60 months to as little as just 1 month. These results indicate that a large majority of the conventional loans provided by commercial banks to firms also receiving policy loans were short term in maturity. The interest rates for these loans spanned from a high of 1.25% per month to a low of 0.65% per month, with an average of 0.91% per month.

In comparison with commercial bank credit lent to firms not receiving policy loans, the size of loan held by firms with subsidised loans (disregarding whether they are policy loans or conventional loans) was much higher. This finding suggests that large firms find it easier to access credit, whether it be provided by DAF, PAF or commercial banks. Firms eligible for policy loans appear to benefit much more than non-eligible firms, in three respects: (1) bigger loan size, (2) longer loan tenors, and (3) lower interest rates. If so, it cannot be argued that the provision of policy loans is complementing commercial bank lending, by serving companies that are unable to gain access to conventional loans. Rather, the policy lending activity is serving as a supplementary credit service, running in parallel with the existing banking sector.

The average ratio of debt to equity for firms that received a policy loan is shown in table 6.15, below. It suggests that the debt-to-equity ratios of sampled firms located in Tien Giang and Binh Duong exceeded 100% (141%), while firms in HCM City are at 67.8%, resulting in an aggregate average ratio across the full sample of 115 firms of 74.9%. The debt-to-equity ratio of policy loan recipient firms is much higher than non-recipients, with the latter averaging just 44.56%. Therefore, it can be argued that, on average, firms receiving policy loans tend to have much higher debt burdens, which has implications in terms of their long-term financial stability. Of all the loans borrowed by firms receiving policy loans, 66% were provided by either DAF or a PAF (see table 29).

Table 28: Debt to Equity Ratio of Enterprises Receiving Preferential Credit

	Average working capital (VND bn)	Average equity (VND bn)	Average liabilities (VND bn)	Average D/E ratio (%)
Tien Giang	24.13	11.76	12.37	105.19
Binh Duong	59.56	24.72	34.84	140.94
HCM City	105.01	62.56	42.44	67.84
Full Sample	89.99	51.47	38.53	74.86

Table 29: Debt Positions, and Sources of Debt, of Surveyed Firms

	Total capital	Of which		DAF/PAF loans		Loans from commercial banks	
		Equity	Debt	Loan size	Policy loans to total loans (%)	Loan size	Commercial loans to total debt (%)
Firms receiving policy loans							
Tien Giang	217.15	105.86	111.29	38.62	34.71	25.58	22.99
Binh Duong	1,131.73	469.71	662.02	163.70	24.73	100.30	15.15
HCM City	8,190.42	4,879.86	3,310.56	2,501.90	75.57	1,407.94	42.53
Full Sample	9,539.30	5,455.43	4,083.87	2,704.22	66.22	1,533.82	37.56
Firms not receiving policy loans							
Tien Giang	178.55	115.05	63.50	-	-	82.70	130.24
Binh Duong	1,274.29	806.93	467.36	-	-	226.50	48.46
HCM City	1,264.10	957.35	306.75	-	-	203.61	66.38
Full Sample	2,716.94	1,879.33	837.61	-	-	512.81	61.22

Table 29 shows the surveyed firms' operating capital and sources of capital, including equity, and loans from both assistance funds and from commercial banks. Commercial bank loans presented here include loans to finance fixed asset purchases, and short-term loans to finance working capital. Therefore, some figures in the last column may be higher than 100%, because it shows the ratio of commercial bank loans to total debts, which exclude short-term loans of 1 to 3 months.

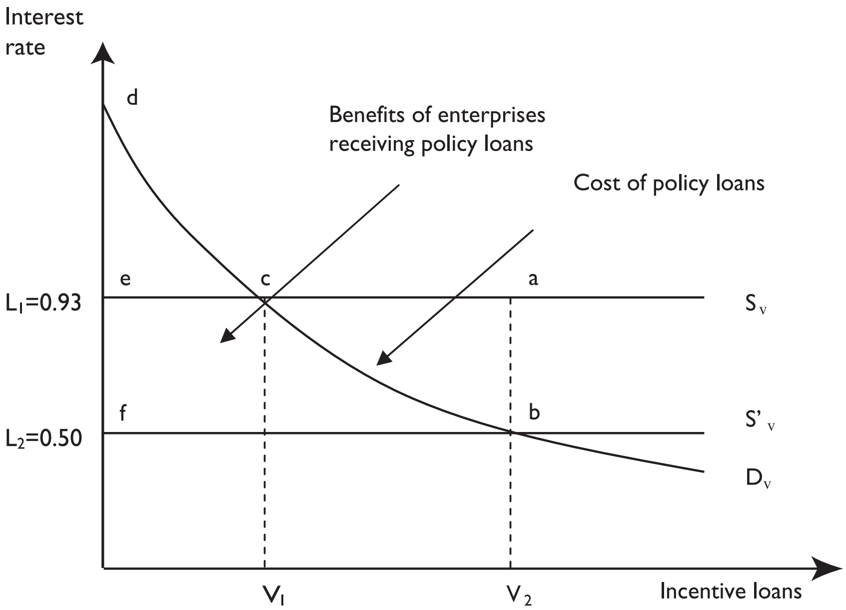
The impact of the subsidised loan policy can be assessed by seeking to answer two questions. Did firms operating in the state-targeted preferential areas of business (ie. firms operating under Lists A, B and C for priority sectors and locations) actually receive any of these policy loans? And what were the actual benefits of the preferential loan policy, and how costly was it to achieve these benefits?

The first question can be answered by comparing the areas of business for our sample of 115 firms that received policy loans, and the list of targeted areas cited in Decree 106 on the policy lending. As we saw in table 22 above, only 23% of the projects that received preferential credit operated within the list of 15 targeted areas cited in Decree 106. The majority of projects that were received preferential credit are operating in other areas of business, and policy loans were mostly used to either finance production expansion or to finance export. It can therefore be inferred that the areas of business which were originally expected to be the recipients of policy loans – through the granting of such loans to firms working in these 15 business sectors – in general, did not gain much access to the loans.

In order to answer the second question, we can use the graph below to illustrate the benefits that firms actually derive from the preferential credit policy, as opposed to commercial rates of interest (see figure 3). The curve Dv presents the demand of borrowing. The horizontal line Sv at the equilibrium price – the market rate of interest L1=0.93 (according to the survey) – graphically symbolizes the supply of credit. Sv shows the marginal social costs of the credit supply.

In the beginning, assume that the interest rate offered by assistance funds equals the rate offered by commercial banks, and the equilibrium amount of policy loans borrowed by firms is V_1. Then, as a result of the preferential credit policy, the government provides subsidy in the form of lower interest rate L_2=0.5% (according to the survey), and the supply curve shifts to the new price-interest rate L_2 and becomes line S'v. Credit subsidies increase borrowings from assistance funds to the amount of V_2. Prior to the subsidy, the consumer surplus is illustrated by the area of the triangle edc[13]. After the subsidy, the consumer surplus is the triangle. The benefit obtained by the borrowers is the increased consumer surplus, which is the area of the trapezium fecb. But how does this benefit compare with the cost? The cost of the credit subsidy is the amount of subsidized credit V_1V_2 multiplied by the interest gap – the difference between the market and the preferential rates of interest (ie. 0.93% - 0.5%), and is illustrated by the area of the rectangle feab. We find that the cost of subsidy actually exceeds the benefit by the area of the triangle abc (ie. the difference between the area of the rectangle feab and the area of the trapezium fecb). The area of triangle abc = 1/2abxac, of which ac=V_1V_2; ab=L_1-L_2. The survey of 115 enterprises found that V_1V_2=VND 2,704 bn; L_1-L_2 = 0.93% - 0.5% = 0.43% per month = 5.16% per year. Therefore, the excess social cost of the subsidy (the cost minus the benefit, or the

Figure 3. Costs and Benefits of the Preferential Credits



area of triangular abc) equals ½ x VND 2,704 bn x 5.16%= VND 69.76 bn.

In short, over the sample of 115 enterprises that received policy loans, the government had to pay an excess cost over the actual benefits derived by these firms, of VND 69.76 bn. Some people may counter that such policy loans create demand for investments, and thus benefit the economy. However, our survey of the firms that received policy loans revealed that nearly 60% of the firms could obtain a similar loan from commercial banks, and the primary reason why they did not borrow from commercial banks, but borrowed from assistance funds instead, was simply because the assistance funds' lending rates of interest were lower. This in turn suggests that if there had not been any assistance funds, 60% of the firms would have borrowed loans of the same size from commercial banks, and demand for investment capital would have risen to meet their business expansion needs.

From this result, we can estimate how much the government has to pay in excess costs, over the actual benefits derived by all firms received policy subsidy loans in Vietnam. According to a recent DAF report, the total value of subsidies by contracts had amounted to VND 96,960 bn. With VND 2,704 bn of subsidies for 115 companies we surveyed, the government had to pay an excess cost over the actual benefits derived by these firms, of VND 69.76 bn. Extrapolating from this, on a figure of VND 96,960 bn, the government would have to pay an excess cost over the actual benefits derived by recipient firms of VND 2,502 bn.

Further, the subsidised loan policy causes unfairness for those firms that are ineligible for such policy

13. Consumer surplus is defined as the amount of money they are willing to pay, minus the actually money paid.

loans. At the preferential annual rate of interest, which is 5.16% lower than the market rate, the debt-to-equity ratio of the eligible firms was approximately 75% (of which more than 66% were policy loans), resulting in a higher return-on-capital for the recipient enterprises compared to the non-recipient enterprises operating in the same industry, of about 5.16% per year at least. Firms that receive policy loans may therefore enjoy higher profitability, not because of their efforts to nurture competitiveness, but because of the advantage they enjoy in having access to cheaper capital (ie. loans with lower interest rates). It is therefore not surprising that in our survey of 115 firms that had not received policy loans, more than 92% of them would be interested in preferential credit if they were offered it.

In summary, current policy lending practices are: i) not being channelled in an optimum manner to areas of business or localities targeted by the government; ii) the cost of providing such loans seems to exceed the benefits that they derive; and iii) are creating an inequitable competitive environment for firms within the same business sectors.

Company Perceptions

To investigate company perceptions about subsidised loans, our survey instrument included a range of comments on the PAFs and DAF branches, to which the 230 surveyed firms were invited to respond. The responses were to: completely disagree; broadly disagree; neutral response; broadly agree; and completely agree. Based on the responses given, we have combined these into just three levels: agree; no opinion; and disagree. The nine comments on DAF and PAF, to which firms were invited to respond, were: (1) Some people say that only those companies with good connections can get a loan from DAF/PAF; (2) Some people say that to get a loan from DAF and PAF, you must be willing to pay unofficial 'commission' (3) Some people say that it is quite difficult to get a loan from DAF/PAF, so most firms don't bother applying for such a loan; (4) Some people say that getting a normal loan from a commercial bank is much less bureaucratic; (5) Some people say that it is not clear which companies are eligible for the DAF/PAF loans, and which are not eligible; (6) Some people say that the actual loan application process is never very clear; (7) Some people say that the loans DAF/PAF provide are mostly for state-owned firms only, not for private companies; (8) Some people say that DAF/PAF only lends to large companies, not small firms, and (9) Some people say that the loans DAF/PAF provide are only for companies or projects that are supported by the local government.

Due to the rather sensitive nature of these questions, the proportion of firms responding with 'no opinion' and 'disagree', from the sub-sample of 115 firms currently receiving subsidised loans was higher than for the other 115 firms that were not recipients of such loans. Or put another way, the companies in our sample that were not beneficiaries of policy loans appeared to be more forthright in the giving their views. Nonetheless, the responses from firms receiving such policy loans are shown in Figures 4 and 5 (also see tables in Appendix 6). It is worth noting that the responses were broadly similar, whether the firms were recipients of a policy loan from the local PAF or the local DAF branch. Comment 9 (Some people say that the loans DAF/PAF provide are only for companies or projects that are supported by the local government) received the largest proportion of agreement amongst firms receiving policy loans (more than 53% of firms borrowing from the local PAF and 48% from the respective DAF branch). The proportion of firms that disagreed with this opinion was 28% for PAF borrowers and 33% for DAF borrowers, while the 'no opinion' response rate was 19% for both PAF and DAF borrowers.

The next highest proportion of agreement was in response to the third comment (Some people say that it is quite difficult to get a loan from DAF/PAF, so most firms don't bother applying for such a loan), with 44% of PAF borrowers and 39% of DAF borrowers replying in the affirmative. Conversely, 34% of PAF borrowers and 45% of DAF borrowers disagreed, and 22% of PAF borrowers and 16% of DAF borrowers had no opinion. On the fourth comment (Some people say that getting a normal loan from a commercial bank is much less bureaucratic), 41% of PAF borrowers and 38% of DAF borrowers concurred, while 29% of PAF borrowers and 28% of DAF borrowers disagreed, and 30% of PAF borrowers and 34% of DAF borrowers expressed no view. Concerning the fifth comment (Some people say that it is not clear which companies are eligible for the DAF/PAF loans, and which are not eligible), 39% of PAF borrowers and 32% of DAF borrowers agreed. On the comment about paying an unofficial commission, just 16% of PAF borrowers and 20% of DAF borrowers agreed. A further 37% of PAF borrowers and 24% of DAF borrowers had no view on this issue, while 47% of PAF borrowers and 46% of DAF borrowers disagreed with this comment. Interestingly, on the sixth comment (Some people say that the actual loan application process is never very clear), only 9% of PAF borrowers and 14% of DAF borrowers agreed, while 60% of PAF borrowers and 56% of DAF borrowers disagreed with this comment.

Finally, for the 115 sampled firms which were not receiving subsidized credit from either a PAF or DAF branch, their responses to the nine comments are slightly different, and perhaps more candid in nature. The highest proportion of agreement (62% of the sub-sample) was in response to the third comment (Some people say that it is quite difficult to get a loan from DAF/PAF, so most firms don't bother applying for such a loan). In contrast, 12% of firms expressed disagreement, while another 26% had no opinion. More than half of firms (52%) agreement with the fifth comment (Some people say that it is not clear which companies are eligible for the DAF/PAF loans, and which are not eligible), while only 19% disagreed, and 29% had no view. The comment that subsidized credit is given only to those projects which are supported by the local government (Question N09) met with 45% agreement, 31% disagreement, and 24% expressing no opinion. Regarding the 'unclear' loan application process, 34% of firms agreed, 25% disagreed and 41% had no view. On the issue of unofficial 'commissions' paid for attaining subsidized loans, just 17% of 115 firms not receiving such loans concurred, while 27% disagreed, and 56% expressed no opinion.

Figure 4: Perceptions of Loan Inventives From DAF - Firms Receiving Incentives

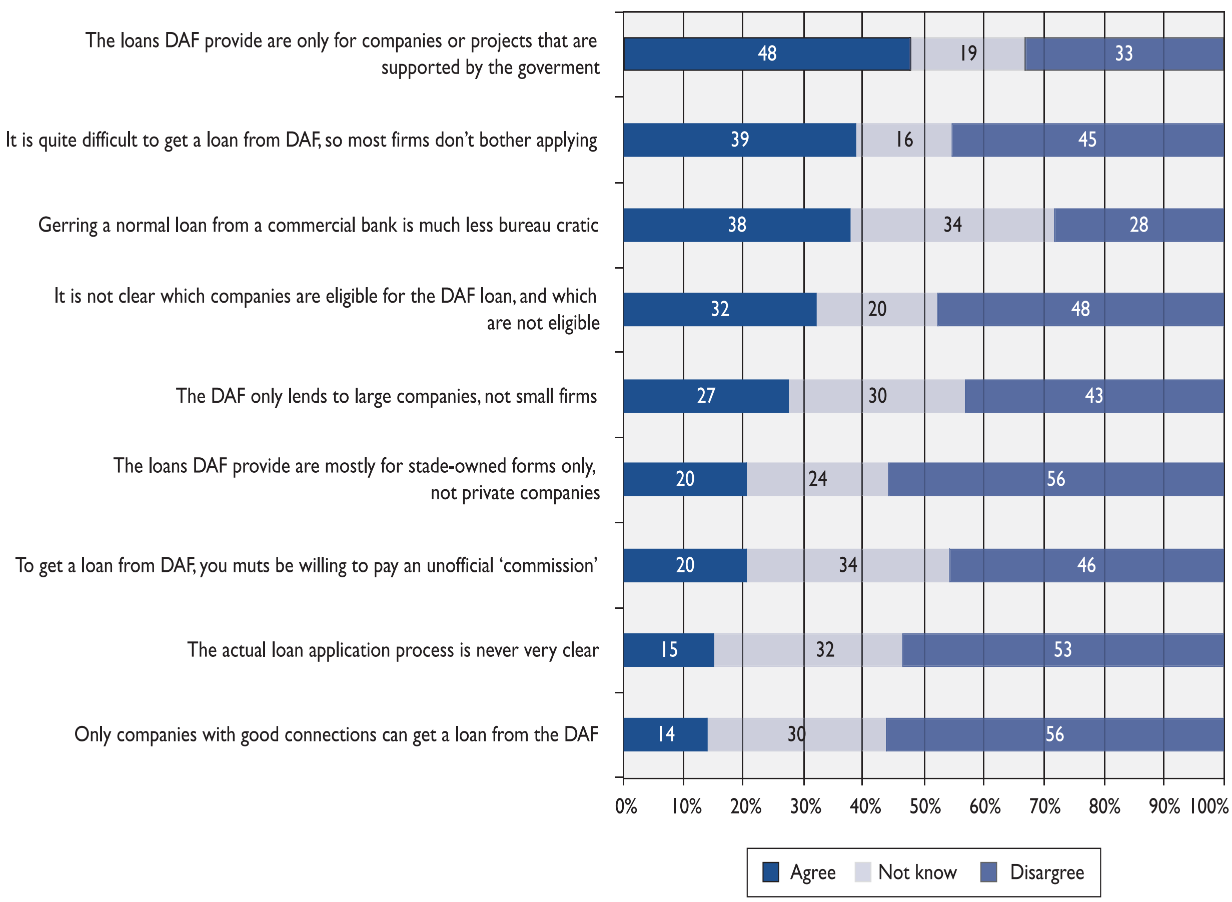
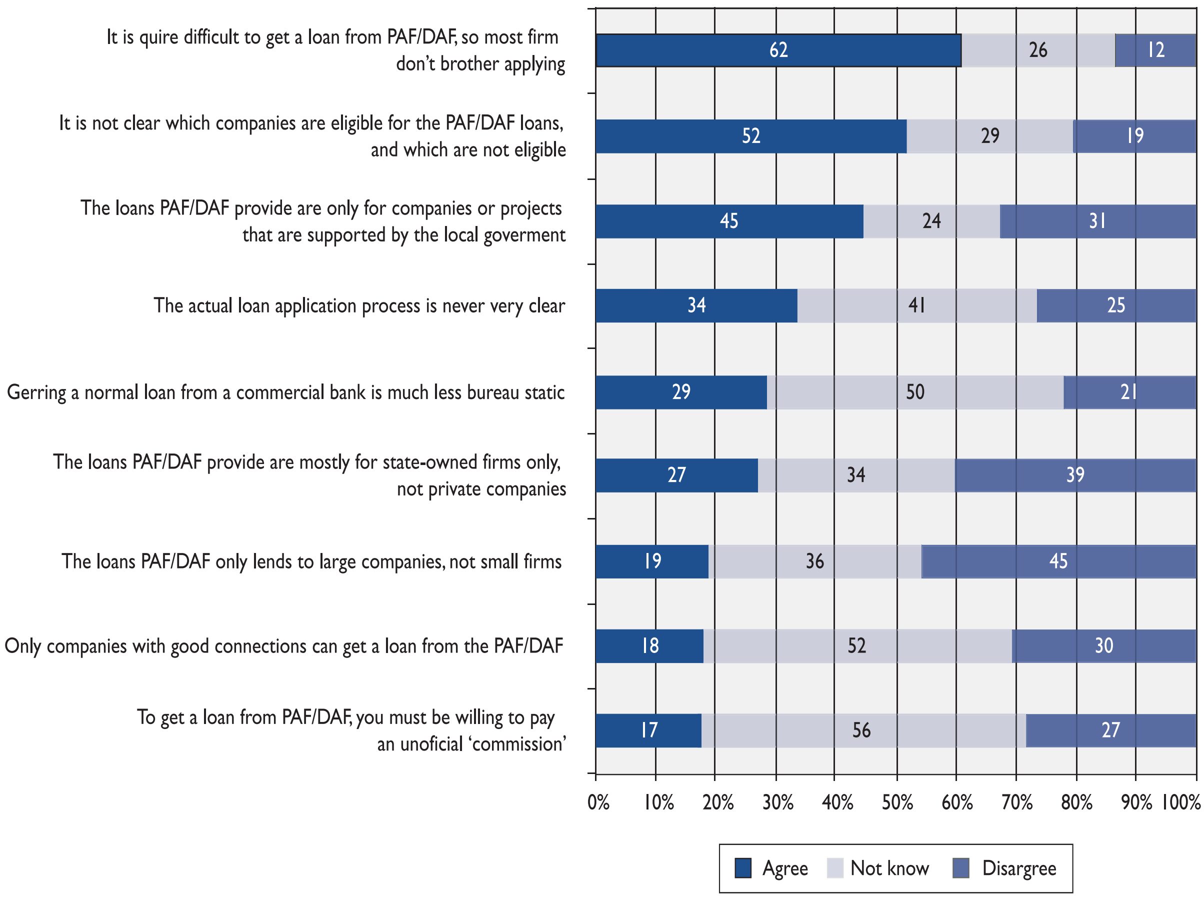


Figure 5: Perceptions of Loan Inventives - Firms not Receiving Incentives



SPECIFIC RECOMMENDATIONS ARISING FROM THIS STUDY

Vietnam is currently seeking to develop a robust financial sector, comprising an array of banking and financial institutions with the capacity and competence to provide a spectrum of financial products and services that meet the needs of a burgeoning, and increasingly, diverse corporate sector community. For such financial institutions to develop and become sustainable, they broadly need to be profitable, otherwise there is little incentive for them to embrace new initiatives and grow. In this context, it is important that the kinds of interventions that the government pursues in this field, at both the national and provincial level, do not have an adverse impact on the viability of commercial banks and financial companies.

For example, for government agencies to be providing loans at interest rate levels that are lower than those offered by commercial banks, to companies that could readily get conventional bank loans, is, at best, duplicating what the market is already doing. At worst, it is undermining the banking sector, and incurs a cost that must be borne by the government (in terms of higher interest earnings foregone). Only where such policy loans are provided to companies that are currently prevented from tapping the commercial banking sector, for whatever reason, and yet have projects that merit some government support, can such an approach be justified. The fact that some PAFs and DAF branches contact commercial banks, in the search for firms and projects to lend to, suggests that they lack a clear strategy in this regard.

It is therefore recommended that the PAFs should seek to disengage from being directly involved in lending activity to firms and projects, particularly where this entails the provision of subsidised credit which serves to undermine the development of the banking sector in that location, primarily by undercutting the commercial banks on the interest rate offered. If the PAFs are to continue direct lending, it is recommended that they seek to do so at market rates, and seek to serve clients that are not able to gain access to conventional commercial bank loans, so as to be complementary – and not 'duplicatory' – in the provision of loans. This could be done in part by introducing financial products and services not already provided much (if at all) by commercial banks and other financial institutions, such as factoring (eg. for firms that are major exporters) or leasing (eg. for firms wishing to install machinery that will entail cleaner production). Where this can be done in conjunction with commercial banks and financial institutions, the better. And if PAFs still feel there is utility in providing conventional loans to eligible companies, to support specific projects that have positive socio-economic impact, it is recommended that this is disbursed, wherever possible, through eligible commercial banks as on-lenders, using instruments such as revolving credit lines. This has the benefit of both harnessing the expertise of commercial banks (from lending appraisal and monitoring skills, to risk management techniques), as well as keeping the operating costs of maintaining parallel institutions to a minimum, thereby optimising the amount of money that can actually be directed at worthy projects.

Notwithstanding the relatively strong internal governance structures within the PAFs, their relationship with the relevant municipal or provincial People's Committee does expose them to some additional business risk, as delivery agents for State-directed financing decisions. There should be sufficient (and implement-able) checks in place to ensure that they are not obliged to pursue loan or investment projects that could imperil their capital base and long-term sustainability. As the majority of funding for some PAFs comes from the provincial budget – as opposed to other potential sources – this places an additional pressure on the PAFs to comply with the wishes of the relevant People's Committee, as their main financial benefactor. This pressure is further reinforced by the fact that senior appointments at the PAF are made by the People's Committee.

Care needs to be taken to ensure that the policy lending and investment activities of DAF and the PAFs do not – and are not perceived to be – in contravention of commitments that Vietnam has made as part of various agreements. If it is perceived that the national or provincial arguments are using the PAFs or DAF branches as vehicles to unfairly provide financial subsidies to favoured companies or business sectors, to the competitive disadvantage of others, this could potentially pose a problem.

If there is an intention to expand the current dozen or so PAFs to a larger number of provinces in the future, there would be utility in devising some uniform regulatory guidelines on their objectives, and how they should go about pursuing these activities. Our impression is that, at present, the different PAFs operate according to differing regulations that are issued at the provincial level. While this may give some flexibility for each PAF to tailor itself better to meet the specific needs of its host province, it also leaves the potential for inconsistencies and errors to be made. One cannot expect every one of Vietnam's 60-plus provinces to have the internal capacity to devise a robust regulatory structure to govern the activities of its respective PAF, and the prospect of every province undertaking the same exercise would suggest a large duplication of effort. There is therefore some merit in considering the drafting of some standard regulatory guidelines, ideally by a body that would also then seek to ensure that such guidelines are enacted in practice. As PAFs do not take deposits, there is probably not a need to put in place the kind of extensive regulatory framework that pertains to commercial banks. But some form of regulatory oversight, at the national level, would appear to be appropriate, particularly if PAFs in the future wish to raise additional funding through the issuance of bonds, or other kinds of debt paper.

There is the potential for unnecessary duplication between the activities of the DAF branch in a province and the local PAF. One way of addressing this issue would be to seek to coordinate the activities of the PAF and relevant DAF branch, and ideally seek to establish strategies that are complementary, as well as being distinct from the lending activities of commercial banks in that locale. (This might event extend to the structuring of syndicated loans.) Just as it is sub-optimal to have policy lenders competing with the commercial banking sector to provide loans to the same client base, it is also not ideal to have different policy lenders competing with each other, particularly when they are in the business of offering subsidised loans.

In the area of risk management, the PAFs appear to be quite weak. The provisioning methods they have adopted, to cover for potential bad debts, do not match very well with the kinds of loan portfolios that they currently hold. Similarly, the capabilities of PAF employees appear to be quite mixed. Credit appraisal, monitoring and repayment activities are a professional skill. For employees that do not have a background (both formal training and experience) in banking, working effectively in a PAF may pose a challenge, unless adequately supported.

Turning to DAF, we have a number of recommendations for consideration, emanating from the findings in our study. In general, they propose that DAF should consider revising its activities to be more complementary with the burgeoning banking and finance sector in Vietnam, as opposed to being a quasi-competitor (with privileged access to cheap sources of funding) to commercial finance providers. This could be done through revisions in the way it seeks to inject funds into eligible projects and companies, by employing a more selective and 'arms length' approach (eg. revolving credit lines and/or a credit guarantee system). If, however, DAF remains a major direct lender to projects and firms, it should consider becoming more transparent and approachable in its activities, as well as taking care not to enter into direct competition with commercial banks, or the growing number of PAFs.

Although DAF does not take retail deposits directly, it does have sources of capital like the Post Office Savings Fund. It therefore should seek to have sufficient provisioning and other risk management techniques that will protect it from undue losses emanating from bad loans. Ideally, these should be as stringent as those applied to commercial banks (as deposit takers), although this does not appear to be the case at present.

As with the PAFs, DAF should seek to avoid competing directly with commercial banks in the provision of loans, given that its privileged access to cheap sources of funding allow it to provide loans at markedly lower rates of the interest than normal banks. A number of strategies could be adopted to prevent this kind of direct competition. One strategy would be to seek, wherever possible, to conduct such lending through the commercial banking sector itself, with DAF simply providing revolving credit lines to eligible banks for on-lending to eligible projects and firms, and overseeing the process. For example, a revolving credit line into a small number of eligible commercial banks, with the right expertise, to support them in the provision of export credit finance to corporate clients that meet a clear set of eligibility criteria.

Another strategy would be to tighten the current eligibility requirements for recipients of DAF funding assistance, to limit the risk of undercutting commercial banks to just a few select areas, and focusing on firms and business sectors that find it difficult to harness normal loans. At present, the impression one gets is that DAF's eligibility requirements for export credit finance and the like is fairly wide, and puts DAF in direct competition with commercial banks in providing such a service across a fairly wide array of business sectors.

Alternatively, DAF could look at introducing new financial services or instruments that fill a current gap in commercial banking and finance, and even help support commercial banks in their financial intermediation role. One such service might be the establishment of a sustainable CGS for SMEs and other borrowers, with DAF playing a central role. The attraction would be that it would take DAF away from directly lending to firms (thereby putting it in competition with commercial banks), and instead become a supportive agent and promoter of conventional bank financing to eligible borrowers that are currently denied adequate access to loans. For example, a CGS that would allow commercial banks to provide loans of longer tenors, so as to support major investment projects that will have a longer payback period.

None of these strategies are mutually exclusive, and so DAF could consider adopting: i) a credit guarantee system to support commercial loans in some sectors; ii) some credit lines to banks to support commercial loans in other sectors; and iii) conceivably remain a direct lender to a few eligible projects and firms in a select number of yet other sectors. All of this could be enacted as DAF converts into the VDB.

We were struck that, although DAF is a direct lender at present, there is surprisingly little information or promotional literature available on its services. For such a large financial institution, relative to other banks in Vietnam, that lends directly to corporate clients, not to have even the most rudimentary website seems odd in this day and age, and tends to add to the general sense of opacity that surrounds DAF. It is perhaps not surprising, then, that a lot of the companies we surveyed were unsure of the eligibility criteria for DAF and PAF funding support, citing a lack of available information.

As noted above, our findings would suggest that current policy lending practices: i) are not being channelled in an optimal manner to areas of business or localities targeted by the government; ii) entail costs to the government of providing such loans that seem to exceed the benefits that recipients derive; and iii) they are creating an inequitable competitive environment for firms within the same business sectors. SOEs and larger firms appear to be favoured in terms of policy loans, if only as a function of the kinds of business they conduct, to the detriment of private SMEs. Mirroring the same problem that has been encountered with investment incentives, it appears that the current eligibility requirements for subsidised loans span a diverse range of sectors. This apparent lack of focus means that less than 15% of the firms in our survey sample came from one of the 15 target sectors identified for special attention by the government in Decree 106.

Instead, we found that more than half of recipient firms of policy loans were also borrowers from commercial banks. Rather than complementing commercial bank lending, the DAF and PAF loans are often supplementing such conventional credit, allowing recipient firms to 'leverage' themselves further. Such survey results would suggest that there appears a need to re-visit the eligibility requirements set for policy loans, and, as with investment incentives, have a more focused (and less complex) approach to the provision of such funding support for specific projects and companies.

A CHECKLIST OF POLICY LENDING CONSIDERATIONS

Try to Avoid:

1. Providing subsidised loan products that inadvertently undermine the activities and long-term development of the commercial banking sector.
2. Offering subsidised loans to individual firms or sectors that will be actionable under WTO regulations, or other international commitments.
3. Offering subsidised loans to firms that can readily access normal commercial loans.
4. Being unduly wide-ranging in the eligibility criteria for policy loan recipients.
5. Being unduly relaxed in regulating for loan risk and other internal controls, particularly if some of the funding stems from 'retail sources', such as post office deposits.
6. Lending directly to firms unless really necessary, and only when more indirect (ie. less distorting) options -- such as credit lines or CGS to commercial banks -- have been completely exhausted.

Try to Achieve:

1. Seek to be complementary in the provision of additional financing products and services that are not already available to some or all sectors, due to a specific irregularity in the commercial banking sector.
2. Seek to support the development of the commercial banking and finance sector, through CGS schemes and the like, that reduce the risks - and therefore the costs - of loan provision.
3. Seek to ensure the costs of providing such policy loans do not exceed the benefits.
4. Seek to be a catalyst and supporter, but not an operator, of new financial products and services.
5. Seek to put in place regulations and internal procedures that ensure financial products and services provided by state agencies are not abused.
6. Seek to coordinate between state agencies (eg. between the local DAF branch and the PAF at the provincial level), and with the commercial banking and finance sector.
7. Seek to be transparent in operations, and in the provision of useful information to the corporate sector.

REFERENCES

Asian Development Bank, GFA Management and Swiss Contact. *Best Practices in Credit Program Design*. Policy discussion paper 4, June 2001.

Bannock & Partners. Credit Guarantee Schemes for Small Business Lending: A Global Perspective. April 1997.

Business Link (UK). *No-nonsense guide to finance for high growth companies*. UK Department of Trade & Industry, January 2005. <www.businesslink.gov.uk>

Business Link (UK). *No-nonsense guide small business funding.* UK Department of Trade & Industry, January 2005. <www.businesslink.gov.uk>

Centre for Economic Development. *Code of Best SME Finance Practices in South Eastern Europe.* 2001.

European Commission. Enterprises' access to finance. Commission staff working paper, October 2001.

Frame, S., Srinivasna, A., Woosley, L. "The effect of credit scoring on small-business lending". *Journal of Money, Credit, and Banking,* 33(3): 813-25, 2001.

Freeman, Nick. *Expanding horizons: equity finance in Vietnam*. MPDF discussion paper number 16, July 2004. <www.mpdf.org>

Gudger, Michael. 'Sustainability of Credit Guarantee Systems', *The Financier*, February/May 1997.

Hallberg, Kristin. *A Market-Oriented Strategy for Small and Medium-Scale Enterprises*. IFC discussion paper 40.

Klapper, Leora. *The Role of Factoring for Financing Small and Medium Enterprises.* World Bank policy research working paper 3593, May 2005.

Levin, R. I., and Travis, V. R. "Growing concern: small companies finance: what the books don't say". Harvard Business Review, 6: 30, 1987.

Oxford Policy Management. *Financing Requirements of Private Enterprises in Developing Countries*. May 2002.

UNCTAD. *Improving the Competitiveness of SMEs in Developing Countries: The Role of Finance to Enhance Enterprise Development.* UNCTAD, 2001.

UNIDO. *Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth?* August 2003.

UNU WIDER. *Comparative Appraisal of Multilateral and Bilateral Approaches to Financing Private Sector Development in Developing Countries.* Discussion paper 2002/112, November 2002.

UNU WIDER. *Sustainability of External Development Financing to Developing Countries.* Policy brief 9, 2004.

USAID. *Credit Guarantee Activities: Year in Review 2003.*

USAID. *Designing Loan Guarantees to Spur Growth in Developing Countries.* 2004.

USAID. *Loan Guarantees: Examples and Lessons Learned*. September 2005.

World Bank. '*Credit Scoring: A Tool for More Efficient SME Lending*', *SME Issues*, vol. 1 no. 1, November 2000.

APPENDIX 1: LEGAL DOCUMENTS THAT REGULATE DAF'S ACTIVITIES

No.	Document reference number and date	Documents	Coverage	Notes
1	Decree 50/1999/NĐ-CP July 8th 1999	Decree of the Government on the Regulations of DAF	Stipulates DAF functions, tasks, authorities, and organization	
2	Circular 51/2005/TT-BTC June 20th 2005	Providing Guidance on the Financial Management of DAF	Stipulates and guides implementation of the regulations about DAF's income and expenditures, and book keeping	
3	Decree 51/1999/NĐ-CP July 8th 1999	Decree to provide detailed regulations on the implementation of the Law on Domestic Investment	Prescribes the list of projects eligible to receive DAF preferential credit	Combined with the list of preferential projects prescribed in Decree 106/2004/NĐ-CP
4	Decree 106/2004/NĐ-CP April 1st 2004	Decree of the Government on the State Development Credit (replacing Decree 43/1999/NĐ-CP of June 29th 1999)	Stipulates the state policy on development credit: forms of supports, list of eligible projects, conditions to receive preferential credit: collateral, interest rates, terms of payment, risk provisions, etc.	Detailed regulations on the credit conditions, interest rates, guarantee period, and list of preferential projects. Subject to changes or modifications by MoF Decisions and Circulars
5	Decree 52/1999/NĐ-CP July 8th 1999	Decree on the Issuance of the Regulations of Investment and Construction Management	Prescribes the classification of projects into categories A, B, or C, and the investment decision making authority of each category. Stipulates the responsibilities and authority of functional state agencies and project owners in managing the investment and construction of projects during the whole 3 stages: investment preparation, investment, completion and operation. The Decree also stipulates responsibilities and authorities of the functional state agencies and the project owners for different sources of funding.	The construction projects shall be approved by functional agencies in compliance with this decree. The project will be granted with credit only if DAF approves its financial and economic effects.

No.	Document reference number and date	Documents	Coverage	Notes
6	Decree 16/2005/NĐ-CP February 7th 2005	Decree of the Government on the Management of the Investment and Construction Projects (providing guidance on the implementation of the Law of Construction)	Prescribes the classification of projects into categories A, B, or C in the construction industry. Stipulates the responsibilities, and authority of the functional state agencies and the project owners in managing the construction of projects: the capabilities of the organization, individual who prepares, surveys, designs, implements, and monitors the construction projects by the project category, and the source of capital.	Construction projects shall be approved by functional agencies in compliance with this decree. The project will be granted with credit only if DAF approves its financial and economic effects.
7	Decision 133/2001/NĐ-TTg September 10th 2001	Decision of the Government about the Issuance of Regulations on Export Finance Credit	Provides regulations on the export support policy of the government: forms of supports, list of eligible projects, conditions to receive preferential credit: collateral, interest rates, terms of payment, risk provisions, etc.	The list of products eligible for support shall be issued by the Ministry of Trade for each specific period.
8	Circular 89/2004/TT-BTC September 3rd 2004	Circular of the MoF providing guidance on the settlement of credit risks associated with the state development investment creditt	Prescribes the risk management process and measures: debt classification, authority to deal with risk associated with each debt class, and the settlement measure.	
9	Decision 06/2004/QĐ-HĐQL January 20th 2004	Decision of DAF Board of Management concerning the Regulations on Financial Appraisal	Prescribes the necessary procedure to apply for preferential credit for each project category (A, B, or C). Guides the operating staff of each branch with respect to the receipt of customers' application. Decentralizes appraisal authority for each project category within DAF system.	The classification of projects into A, B, C categories are prescribed in Decree 52/1999/NĐ-CP, Decree 16/2005/NĐ-CP, and Decision 133/2001/QĐ-TTg.
10	Decision 07/2004/QĐ-HĐQL January 28th 2004	Regulations on the mobilization, receipt, management, and using the Development Investment Credit at DAF	Prescribes the sources of capital mobilization for DAF, the objectives of DAF funding, and the management of capital transfers between Central DAF and its provincial branches	
11	Decision 59/2004/QĐ-HĐQL August 31st 2004	Decision of DAF Board of Management about the Issuing of the Regulation on the Lending of Development Investment Credit	Concretizes the contents of Decree 106 and other related regulations on the mid- and long-term lending using the state development investment credit: grantees, credit terms, interest rates, collateral, application, principal and interest collection, approval authority, etc.	

No.	Document reference number and date	Documents	Coverage	Notes
12	Decision 60/2004/ QĐ-HĐQL August 31st 2004	Regulations on post-investment interest subsidies	Concretizes the contents of Decree 106 and other related regulations on post-investment interest subsidies: guarantees, level of subsidies, application, approval authority, etc.	
13	Decree 178/1999/ NĐ-CP December 29th 1999	Decree of the Government regulating the loan collaterals of credit institutions	Prescribes matters relating to the collateral at credit institutions	
14	Decision 148/QĐ-HTPT March 22nd 2005	Decision of DAF General Director about the Decentralization of lending decisions and management of projects that receive state development investment credit within the DAF system	Prescribes the decentralization of authority to appraise, sign credit contract, extend credit Prescribes the level of loans to each project category	Replaces Decision 37/2004/QĐ-HTPT of January 29th 2004

APPENDIX 2: REGULATORY DOCUMENTS PERTAINING TO HIFU

Document	Title	Principal content
644/TTg	Decision of PM dated 10/09/1996 on "establishment of HCM City Investment Fund for Urban Development "	Stipulating the functions, authorization and organization structure of HIFU
1148/ QĐ-UB-KT	Decision of HCMC People Committee dated 15/03/1997 on "issuing the Charter of HIFU"	Issuing HIFU's Charter
441 TC/TCNH	License for HIFU	
43 TC/TCNH	Circular of MoF on "Guidance for financial management of HIFU"	Issuing financial management regular of HIFU: regulation on fund mobilizing, fund using, revenue, expenses, distribution of profit, financial statements and auditing.
04/2000/CT-UB-KT	Direction No.04/2000/CT-UB-KT dated 23/02/2000 of HCM City People's Committee on the implementation of program" Supporting enterprises to modernize at low cost, create combined competitive advantages and increase export" in years 2000-2003	Giving direction for program "Demand stimulating for technology and equipment modernizing and deployment of pollution reducing fund.
15/2000/ QĐ-UB-TH	Decision No.15/2000/QD-UB-TH dated 17/04/2000 of HCM City People's Committee on The issuing regulation of borrowing, paying loan and interest rate assistance for investment projects under the "Demand stimulating program" of HCM City.	Stipulating the enterprises and organizations eligible for credit subsidy, investors, the source of subsidised funds and form of subsidy.
81/2001/QĐ-UB	Decision No. 81/2001/QD-UB dated 19/09/2001 of HCM City People's Committee on providing amendment of and supplement to a number of articles of Decision No.15/2000/QD-UB-TH.	

Document	Title	Principal content
87/2003/QĐ-UB	Decision No.87/2003/QD-UB dated 20/05/2003 of HCM City People's Committee on providing amendment of and supplement to a number of articles of Decision No.81/2000/QD-UB.	
Not known	People's Committee of HCM City	Regulation on subsidy for "prior goods".
967/QĐ-QĐT	Decision of Board of Director on issuing Regulation on Credit of HIFU. Dated 29/12/2004.	Credit Regular for lending activity of HIFU: the lending principles, lending criteria, interest rates, terms, collateral, authorization in making lending decision, etc.
953/QĐ-QĐT	Decision of Board of Director on issuing Regulation on Appraisal Procedures of HIFU. Dated 29/12/2004.	Stipulates the content of appraisal work, appraisal documents and authorization of Appraisal Committee
178/1999/NĐ-CP	Regulation on loan assurance of credit institutions. Dated 29/12/1999.	Stipulating the relevant content of assets used as collateral in credit institutions.

APPENDIX 3: REGULATORY DOCUMENTS PERTAINING TO TIEN GIANG PAF

Document	Title	Content
Decision 21/2001/QĐ-UB dated 8/6/2001	Regulations of activities' organisation in Tien Giang PAF.	Stipulation of functions, authority and organisation of the PAF.
Decision 33/2004/QĐ-UB	Regulation about lending by PAF.	Legal document stipulating about lending procedures: target applicants, lending terms and conditions, loan maturity and lending interest rate, loan register, appraisal process and making decision, supervision lending capital and loan repayment.
Decision 32/2004/QĐ-UB	Stipulation of security for loan by PAF.	Detailed stipulations of security for loan for customers, PAF's authority and responsibility in accepting assets for loan security and management of the assets, appraising assets for loan security, defining lending capital accordingly with asset's value, stipulating security of lending capital with asset for security formulating from lending capital, detailed stipulations about lending project and the conditions of lending without assets for loan security.
04/CV-3/2/04	Official correspondence requesting adjusting and adding regulations in lending and loan security, issued by the PAF's management board.	Adjusted, supplemented and detailed regulations of PAF's lending capital policy.
43/1999/NĐ – CP	State credit, investment and development. Dated 23/6/99.	Based on this Decree, stipulations about eligibility of receiving loan with subsidy and terms and conditions will be set up.
Decree 178/1999/NĐ CP	Government's decree of loan security by credit agencies	Based on this Decree, stipulations about assets for security for loan, appraisal of the assets, authority and responsibility of PAF and customers, lending amount, etc. will be formulated.
Decree 85/2002/NĐ-CP	Adjustment of Decree N^0 178	Stipulations about assets for security for loan.
07/2003 TT-NHNN	State Bank Circular giving guidance for credit agencies about requirements and stipulations of loan security.	Stipulations about assets for security for loan.

APPENDIX 4: BRIEF PROFILE OF DAF'S PRODUCTS AND SERVICES

At present, DAF provides the following kinds of credit assistance:

(1) Medium- to long-term development credit with preferential interest rates:

- Preferential projects covered by the lists in Decree 106/2004/NĐ-CP and Decision 54/2004/QD-BTC, that identify qualified projects.
- A maximum loan tenor of up to 12 years. In special cases, the term can be extended to a maximum of 15 years (eg. for forest plantation projects to supply materials for the paper industry, plywood and processed wood; projects manufacturing some forms of machinery, steel, DAP fertilizer, and nitrogenous fertilizer of group A).
- Interest rates are subject to change, as instructed by the MoF for a specific period. The current interest rate is 7.8 % per annum, which is lower than the average medium- and long-term interest rates of around 12% offered by commercial banks
- The size of loan depends on the specific project, up to a maximum of 70% of the project's approved fixed assets.
- For collateral, recipients may use assets financed by loans.

(2) Loans to projects under Government-to-Government agreements:

- For investment projects granted by the Vietnamese Government. The conditions of lending are usually provided in the agreement between Vietnam and the other country.

(3) Post-investment interest subsidies:

- Eligible projects are those in the list issued with Decree 106/2004/NĐ-CP, but which have received none, or only partial, State preferential development credits; and projects in the list of qualified recipients under the Law on Domestic Investment and Decree 51, but have not received other preferential loans or credit guarantees.
- For VND loans, the annual interest rate subsidy is 50% of the current preferential interest, which is 3.9% of the loan amount. For foreign currency loans, the annual interest subsidy will be 35% of the current lending interest rate, as applied by the domestic credit institutions, which is about 2.1% of the actual loan amount.

(4) Credit Guarantees:

- Eligible recipients projects are those in the list issued with Decree 106/2004/NĐ-CP, but which have received none, or only partial, State preferential development credits; and projects in the list of qualified recipients under the Law on Domestic Investment and Decree 51, but have not received other preferential loans or credit guarantees.
- Up to 70% of the total approved investment on fixed assets may be guaranteed.

(5) Short-term export finance credit:

- Eligible enterprises are those producing items included within the export promotion program, as stipulated by the Prime Minister for each period (a list of projects is prepared by the Ministry of Trade). Projects with projected annual export revenues of 30% or higher, and are qualified for DAF preferential investment credit, will be eligible for short-term credit in the first year of operations; export contracts to new markets, or to maintain traditional markets, as determined by the Prime Minister.
- The credit term may not exceed 12 months. A fixed interest rate of 80% of the development investment credit interest rate, at the time of signing the credit contract. With the current development interest rate at

7.8%, the export finance credit interest is about 6.25% per year, which is markedly lower than the current short-term interest of commercial banks (around 11.4% per year).

- The scale of credit varies. For pre-delivery loans: enterprises eligible for short-term loans to purchase materials and production factors to carry out export contracts can be provided up to 80% L/C or up to 70% of the contract value. (With regard to export products with quotas, the maximum credit will be the value of unused quota, as of the date of borrowing.) For post-delivery loans: the post-delivery loans are accepted when the enterprise submits the bill of exchange. The level of credit will be up to 90% of the value of the valid B/E.
- Collateral requirements are equivalent to 30% of the loan amount for pre-delivery loans. For post-delivery loans, the enterprise must provide the valid B/E and other export documents.

(6) On-lending activities for ODA projects:

- For eligible projects, as assigned by the Minister of Finance. Conditions for on-lending are usually set in the documentation for each project, as agreed with the ODA source.

(7) Entrusted funds:

- Eligible recipients are typically those identified by the fund owners. For example, HCM City People's Committee entrusts DAF to lend to the Thu Thiem project and a high-tech project. For projects in areas such as electricity, that are directly under the management of other agencies, DAF solely manages the

APPENDIX 5: BRIEF PROFILE OF DAF'S FINANCIAL MANAGEMENT

Management of DAF Finance	
1. Income and expenditure	DAF's main income is from: the collection of interest associated with development credit (excluding interest from on-lending of ODA and trust fund loans); short-term interest associated with the export-finance credit; interest from deposit accounts at the Treasury; management fees of trust funds; and management fees for on-lending of ODA. DAF's main expenditures consist of: Operating expenses (interest payment associated with mobilized capital; trust fund loan collection fees, provisioning for risks, and other operating expenses). Management expenses: up to 30% of the actual collected interest (excluding interest payments from on-lending ODA, trust fund loans, and interest from accounts at the Treasury and banks). Management expenses include salaries, allowances for DAF officers; administration expenses, rental, etc. If income exceeds expenditures, 50% of the excess income will be allocated to the development investment for DAF, and the remainder will be allocated to the Reward and Welfare fund (up to 3 months' salary) and to supplement chartered capital. If income is less than expenditures, the loss will be reported to the MoF for settlement.
2. Management of capital flows	Central DAF manages the flow of capital between it and the DAF branches. Branches may not manage in-flows and out-flows between each other.
3. Provisioning for credit risks	The temporary annual provision of credit risk is 0.2% of the average outstanding loans and credit guarantees. This provision is regarded as a cost. Unlike commercial banks, provisioning is not based on any loan classification system.

APPENDIX 6: COMPANY SURVEY RESULTS ON FIRMS' PERCEPTIONS

Table A6.1: Perceptions of Firms Receiving Subsidized Loans From DAF Branches

	Tien Giang			Binh Duong			HCM City			Whole sample		
	Disagree	**Not know**	**Agree**	**Disagree**	**Not know**	**Agree**	**Disagree**	**Not know**	**Agree**	**Disagree**	**Not know**	**Agree**
Total number of firms		10			20			85			115	
Total number of firms answering		8			8			72			88	
1. Only companies with good connections can get a loan from the DAF	2	4	2	6	1	1	41	22	9	49	27	12
	25.00%	50.00%	25.00%	75.00%	12.50%	12.50%	56.94%	30.56%	12.50%	55.68%	30.68%	13.64%
2. To get a loan from DAF, you must be willing to pay an unofficial 'commission'	4	4	0	3	4	1	33	22	17	40	30	18
	50.00%	50.00%	0.00%	37.50%	50.00%	12.50%	45.83%	30.56%	23.61%	45.45%	34.09%	20.45%

TTable A6.1: Perceptions of Firms Receiving Subsidized Loans From DAF Branches (continue)

	Tien Giang			Binh Duong			HCM City			Whole sample		
	Disagree	Not know	Agree	Disagree	Not know	Agree	Disagree	Not know	Agree	Disagree	Not know	Agree
3. It is quite difficult to get a loan from DAF	3	0	5	8	0	0	29	14	29	40	14	34
	37.50%	0.00%	62.50%	100.00%	0.00%	0.00%	40.28%	19.44%	40.28%	45.45%	15.91%	38.64%
4. Getting a loan from a commercial bank is much less bureaucratic	1	4	3	3	2	3	21	24	27	25	30	33
	12.50%	50.00%	37.50%	37.50%	25.00%	37.50%	29.17%	33.33%	37.50%	28.41%	34.09%	37.50%
5. It is not clear which companies are eligible for the DAF loans	2	2	4	6	2	0	34	14	24	42	18	28
	25.00%	25.00%	50.00%	75.00%	25.00%	0.00%	47.22%	19.44%	33.33%	47.73%	20.45%	31.82%
6. The actual loan application process is never very clear	4	3	1	3	4	1	40	21	11	47	28	13
	50.00%	37.50%	12.50%	37.50%	50.00%	12.50%	55.56%	29.17%	15.28%	53.41%	31.82%	14.77%

Table A6.1: Perceptions of Firms Receiving Subsidized Loans From DAF Branches (continue)

	Tien Giang			Binh Duong			HCM City			Whole sample		
	Disagree	Not know	Agree	Disagree	Not know	Agree	Disagree	Not know	Agree	Disagree	Not know	Agree
7. The loans DAF provide are mostly for state-owned firms only	3	4	1	5	3	0	41	14	17	49	21	18
	37.50%	50.00%	12.50%	62.50%	37.50%	0.00%	56.94%	19.44%	23.61%	55.68%	23.86%	20.45%
8. The DAF only lends to large companies	3	4	1	7	1	0	28	21	22	38	26	24
	37.50%	50.00%	12.50%	87.50%	12.50%	0.00%	38.89%	29.17%	30.56%	43.18%	29.55%	27.27%
9. The loans DAF provide are only for projects supported by the local government	3	4	1	5	0	3	21	13	37	29	17	42
	37.50%	50.00%	12.50%	62.50%	0.00%	37.50%	29.17%	18.06%	51.39%	32.95%	19.32%	47.73%

Table A6.3: Perceptions of Firms not Receiving Subsidized Loans

	Tien Giang			Binh Duong			HCM City			Whole sample		
	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree
Total number of firms non receiving incentives	10			20			85			115		
1. Only companies with good connections can get a loan from the PAF	2	3	5	2	13	5	30	44	11	34	60	21
	20.00%	30.00%	50.00%	10.00%	65.00%	25.00%	35.29%	51.76%	12.94%	29.57%	52.17%	18.26%
2. To get a loan from PAF, you must be willing to pay an unofficial 'commission'	2	6	2	2	15	3	27	43	15	31	64	20
	20.00%	60.00%	20.00%	10.00%	75.00%	15.00%	31.76%	50.59%	17.65%	26.96%	55.65%	17.39%
3. It is quite difficult to get a loan from PAF	1	1	8	0	3	17	13	26	46	14	30	71
	10.00%	10.00%	80.00%	0.00%	15.00%	85.00%	15.29%	30.59%	54.12%	12.17%	26.09%	61.74%
4. Getting a normal loan from a commercial bank is much less bureaucratic	0	4	6	4	4	12	20	50	15	24	58	33
	0.00%	40.00%	60.00%	20.00%	20.00%	60.00%	23.53%	58.82%	17.65%	20.87%	50.43%	28.70%
5. It is not clear which companies are eligible for the PAF loans	3	3	4	0	7	13	19	23	43	22	33	60
	30.00%	30.00%	40.00%	0.00%	35.00%	65.00%	22.35%	27.06%	50.59%	19.13%	28.70%	52.17%

Table A6.3: Perceptions of Firms not Receiving Subsidized Loans

	Tien Giang			Binh Duong			HCM City			Whole sample		
	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree	Dis-agree	Not know	Agree
6. The actual loan application process is never very clear	0	4	6	2	9	9	27	34	24	29	47	39
	0.00%	40.00%	60.00%	10.00%	45.00%	45.00%	31.76%	40.00%	28.24%	25.22%	40.87%	33.91%
7. The loans PAF provide are mostly for state-owned firms only	1	2	7	3	12	5	41	25	19	45	39	31
	10.00%	20.00%	70.00%	15.00%	60.00%	25.00%	48.24%	29.41%	22.35%	39.13%	33.91%	26.96%
8. The PAF only lends to large companies	2	5	3	5	12	3	45	24	16	52	41	22
	20.00%	50.00%	30.00%	25.00%	60.00%	15.00%	52.94%	28.24%	18.82%	45.22%	35.65%	19.13%
9. The loans PAF provide are only for projects supported by the local government	2	3	5	2	2	16	32	22	31	36	27	52
	20.00%	30.00%	50.00%	10.00%	10.00%	80.00%	37.65%	25.88%	36.47%	31.30%	23.48%	45.22%

APPENDIX 7: QUESTIONNAIRES

Firm questionnaire on policy lending for companies receiving a policy loan

1. Company profile

1. Name of the company: ………………………………………………………………………………………..……

2. Address of the company: ………………………………………………………………………………………

Street: ……………………………………………………………………………………………………

Town or district: ……………………………………………………………………………………………...

Province or municipality: ………………………………………………………………………………………

3. Telephone and fax of the company: …………………………………………………………………………..

4. Name of company representative: …………………………………………………………………………..

5. Position of company representative: ………………………………………………………………………….

6. Primary business of the company: ……………………………………………………………………………

7. Secondary business (if any): ………………………………………………………………………………….

8. Type of company:

❒ Limited liability firm

❒ Joint stock firm

❒ Equitised company

❒ State-owned enterprise

❒ Other: (please specify) ……………………………………………………………………………

9. Total capital of company: ………………………………………………………………………. (VND millions)

9.1. Equity: ……………………………………………………………………………………. (VND millions)

9.2. Loans: …………………………………………………………………………………….. (VND millions)

10. Does your company currently hold an investment incentive certificate ?

❒ Yes ❒ No (go to question) ❒ Don't know (go to question)

11. If yes, your eligibility for such a certificate (under Decree 51) is because:

❒ Your company is in List A of priority business sectors

❒ Your company is in List B of locations with difficult conditions

- ❒ Your company is in List C of locations with very difficult conditions
- ❒ Other reason (please specify):

....

....

2. Issues and practices pertaining to the policy loan

12. Does your company currently receive a loan from:

- ❒ The local provincial assistance fund (PAF)
- ❒ The local branch of the Development Assistance Fund (DAF)
- ❒ Other state agency / non-bank institution (please specify):

....

13. What kind of loan / lending incentive is it ?

- ❒ A long-term or medium-term credit
- ❒ Subsidised interest loan after investment
- ❒ Export credit
- ❒ Other (please specify):

....

14. What are the basic terms of the loan ?

Size of loan: .... (VND millions)

Duration: .... (months)

Interest rate: .... (% per month)

15. What specific kind of business project is the loan being used for (using the criteria provided in Decree 106) ?

- ❒ Projects taking place in areas belong to list B, C of Decree 51: to afforest for paper production, production of paper powder and MDF together with processing
- ❒ Project of production original and new seeds, breeds using high technology
- ❒ Clean water supply for living usage
- ❒ Production of industrial salt
- ❒ Production of antibiotics
- ❒ Vocational Training schools in rural areas
- ❒ Projects to build complete printing and dyeing factories
- ❒ Alumni mining and producing, steel refining from ore, special steel production

- ❒ Bus making with "domestically produced rate" larger than 40%, locomotive making and assembling, railroad car making in domestic factories, ship buildings
- ❒ Producing diesel engines with capacity larger than 300 CV
- ❒ Production of new and heavy mechanical products, casting project of large scale
- ❒ Large hydroelectric plant for emigrant purposes and domestic equipment making in areas belong to list B, C in Decree 51
- ❒ Production of nitrogenous fertilizers, DAP
- ❒ To use as equity in projects borrowing ODA funds
- ❒ Other (please specify):

....

16. Are there any major conditions attached to the loan ?

❒ Yes ❒ No (go to question 18)

17. If yes, please specify:

1. ....
2. ....
3. ....

18. Do you think you could get a loan of roughly the same size from a normal commercial bank ?

❒ Definitely yes ❒ Probably yes ❒ Neutral ❒ Probably not ❒ Definitely not

19. If you answered 'definitely yes' or 'probably yes' to the previous question, what were the main factors that otivated your company to get a loan from the PAF / DAF, rather than from (or in addition to) a normal ommercial bank ?

- ❒ Lower rate of interest
- ❒ Lower collateral requirements
- ❒ More attractive loan terms/conditions (please give details) ....

....

- ❒ Other factor (please specify) ....
- ❒ Other factor (please specify) ....
- ❒ Other factor (please specify) ....

20. Looking back, how easy was it to apply for the PAF/DAF loan ?

❒ Very easy ❒ Easy ❒ Neutral ❒ Quite hard ❒ Very hard

Please give the reasons for your answer:

1..

2..

3..

21. Does your company currently have any loans with a commercial bank, in addition to the PAF/DAF loan ?

❒ Yes (go to question 24) ❒ No

22. If no, what are the main reasons why not ?

1..

2..

3..

(go to question 29)

23. If yes, what are the basic terms of the commercial loan ?

Size of loan: .... (VND millions)

Duration: .... (months)

Interest rate: .... (% per month)

24. Do you think it is easier or harder to get a loan from the PAF/DAF than from a normal commercial bank ?

❒ Much easier ❒ Slightly easier ❒ Neutral ❒ Slightly harder ❒ Much harder

Please give the reasons for your answer:

1..

2..

3..

25. With regard to applying for a loan, is the PAF/DAF different from a normal commercial bank ?

❒ Yes ❒ No (go to question 27)

26. If yes, in what ways is it different ?

1..

2..

3..

27. With regard to monitoring and repaying the loan, is the PAF/DAF different from a normal commercial bank ?

❒ Yes ❒ No (go to question 29)

28. If yes, in what ways is it different ?

1……..

2……………………………………………………………………………………………………….

3. ………………………………………………………………………………………………………

3. Perceptions

29. Please indicate whether you agree or disagree with these impressions of the **local PAF** on the following issues:

29.1. Some people say that only companies with good connections can get a loan from the PAF

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.2. Some people say that to get a loan from PAF, you must be willing to pay an unofficial 'commission'

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.3. Some people say that is quite difficult to get a loan from PAF, so most firms don't bother applying

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.4. Some people say that getting a normal loan from a commercial bank is much less bureaucratic

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.5. Some people say that it is not clear which companies are eligible for the PAF loans, and which are not eligible

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.6. Some people say that the actual loan application process is never very clear

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.7. Some people say that the loans PAF provide are mostly for state-owned firms only, not private companies

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.8. Some people say that the PAF only lends to large companies, not small firms

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

29.9. Some people say that the loans PAF provide are only for companies or projects that are supported by the local government

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30. Please indicate whether you agree or disagree with these impressions of the local DAF branch on the following issues:

30.1. Some people say that only companies with good connections can get a loan from the DAF branch

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.2. Some people say that to get a loan from DAF, you must be willing to pay an unofficial 'commission'

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.3. Some people say that it is quite difficult to get a loan from them, so most firms don't bother applying

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.4. Some people say that getting a normal loan from a commercial bank is much less bureaucratic

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.5. Some people say that it is not clear which companies are eligible for DAF loans, and which are not eligible

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.6. Some people say that the actual loan application process is never very clear

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.7. Some people say that the loans DAF provide are mostly for state-owned firms only, not private companies

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.8. Some people say that they only lend to large companies, not small firms

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

30.9. Some people say that the loans the DAF branch provide are only for companies or projects that are supported by the government

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

Firm questionnaire on policy lending for companies not receiving a policy loan

1. Company profile

1. Name of the company: ……………………………………………………………………………..…………………

2. Address of the company: ………………………………………………………………………………………………

Street: ……

Town or district: ……………………………………………………………………………………………...

Province or municipality: ………………………………………………………………………………………

3. Telephone and fax of the company: ……………………………………………………………………………

4. Name of company representative: ……………………………………………………………………………

5. Position of company representative: ………………………………………………………………………………

6. Primary business of the company: ………………………………………………………………………………

7. Secondary business (if any): ……………………………………………………………………………………

8. Type of company:

- ❒ Limited liability firm
- ❒ Joint stock firm
- ❒ Equitised company
- ❒ State-owned enterprise
- ❒ Other: (please specify)

....

9. Total capital of company: .... (VND millions)

9.1. Equity: .... (VND millions)

9.2. Loans: .... (VND millions)

10. Does your company currently hold an investment incentive certificate ?

❒ Yes ❒ No (go to question 12) ❒ Don't know (go to question 12)

11. If yes, your eligibility for such a certificate (under Decree 51) is because:

- ❒ Your company is in List A of priority business sectors
- ❒ Your company is in List B of locations with difficult conditions
- ❒ Your company is in List C of locations with very difficult conditions
- ❒ Other reason (please specify):

....

....

2. Issues and practices pertaining to policy loans

12. Do you think your company is technically eligible for a subsidised loan from the local PAF / DAF branch ?

❒ Yes ❒ No ❒ Don't know

13. If yes, has your company ever applied for such a loan ?

❒ Yes ❒ No (go to question 15)

14. If yes, why was your company not successful in attaining such a loan ?

1..

2..

3. ....

15. If no, why has your company not considered applying for such a loan ?

1...

2...

3...

16. If the local PAF/DAF branch approached your company and offered to provide a subsidised loan, would you be potentially interested ?

❒ Yes [go to question 18] ❒ No

17. If you answered 'no' to the previous question, please give the reasons for your answer:

1...

2...

3...

18. Does your company currently have any loans with a commercial bank ?

❒ Yes [go to question 20] ❒ No

19. If no, what are the main reasons why not ?

1...

2...

3...

(go to question 21)

20. If yes, what are the basic terms of the commercial loan ?

Size of loan: .... (VND millions)

Duration: .... (months)

Interest rate: .... (% per month)

21. Overall, do you think it would be easier or harder to get a loan from the PAF/DAF than from a normal commercial bank ?

❒ Much easier ❒ Slightly easier ❒ Neutral ❒ Slightly harder ❒ Much harder

Please give the reasons for your answer:

1...

2...

3...

3. Perceptions

22. Please indicate whether you agree or disagree with these impressions of the local PAF on the following issues:

22.1. Some people say that only companies with good connections can get a loan from the PAF

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.2. Some people say that to get a loan from PAF, you must be willing to pay an unofficial 'commission'

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.3. Some people say that is quite difficult to get a loan from PAF, so most firms don't bother applying

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.4. Some people say that getting a normal loan from a commercial bank is much less bureaucratic

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.5. Some people say that it is not clear which companies are eligible for the PAF loans, and which are not eligible

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.6. Some people say that the actual loan application process is never very clear

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.7. Some people say that the loans PAF provide are mostly for state-owned firms only, not private companies

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.8. Some people say that the PAF only lends to large companies, not small firms

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

22.9. Some people say that the loans PAF provide are only for companies or projects that are supported by the local government

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

23. Please indicate whether you agree or disagree with these impressions of the local DAF branch on the following issues:

23.1. Some people say that only companies with good connections can get a loan from the DAF branch

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

23.2. Some people say that to get a loan from DAF, you must be willing to pay an unofficial 'commission'

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

23.3. Some people say that it is quite difficult to get a loan from them, so most firms don't bother applying

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

23.4. Some people say that getting a normal loan from a commercial bank is much less bureaucratic

❒Completely disagree ❒Broadly disagree ❒Neutral ❒Broadly agree ❒Completely agree

23.5. Some people say that it is not clear which companies are eligible for DAF loans, and which are not eligible

❐Completely disagree ❐Broadly disagree ❐Neutral ❐Broadly agree ❐Completely agree

23.6. Some people say that the actual loan application process is never very clear

❐Completely disagree ❐Broadly disagree ❐Neutral ❐Broadly agree ❐Completely agree

23.7. Some people say that the loans DAF provide are mostly for state-owned firms only, not private companies

❐Completely disagree ❐Broadly disagree ❐Neutral ❐Broadly agree ❐Completely agree

23.8. Some people say that they only lend to large companies, not small firms

❐Completely disagree ❐Broadly disagree ❐Neutral ❐Broadly agree ❐Completely agree

23.9. Some people say that the loans the DAF branch provide are only for companies or projects that are supported by the government

❐Completely disagree ❐Broadly disagree ❐Neutral ❐Broadly agree ❐Completely agree

DAI

Development Alternatives, Inc. (DAI) is a global consulting firm providing social and economic development solutions to governments, communities, and companies with projects in developing and transitioning countries. Founded in 1970 and headquartered in the Washington, DC area, DAI now includes companies in Brazil, South Africa, Palestine, and the United Kingdom. DAI's 1,600 employees work in 75 countries. Clients include global development agencies, international lending institutions, global corporations, and host country governments.

The Asia Foundation

The Asia Foundation is a non-profit, non-governmental organization committed to the development of a peaceful, prosperous, and open Asia-Pacific region. The Foundation supports programs in Asia that help improve governance and law, economic reform and development, women's participation, and international relations. Drawing on 50 years of experience in Asia, the Foundation collaborates with private and public partners to support leadership and institutional development, exchanges, and policy research. With a network of 17 offices throughout Asia, an office in Washington, D.C., and its headquarters in San Francisco, the Foundation addresses these issues on both a country and regional level.

U.S. Agency for International Development
Regional Development Mission - Asia
USAID/Vietnam Program Office
Tung Shing Square Tower Building, 15th Floor, 2 Ngo Quyen Street
Hanoi, Vietnam
Tel : (84-4) 935-1260
Fax: (84-4) 935-1176
www.usaid.gov