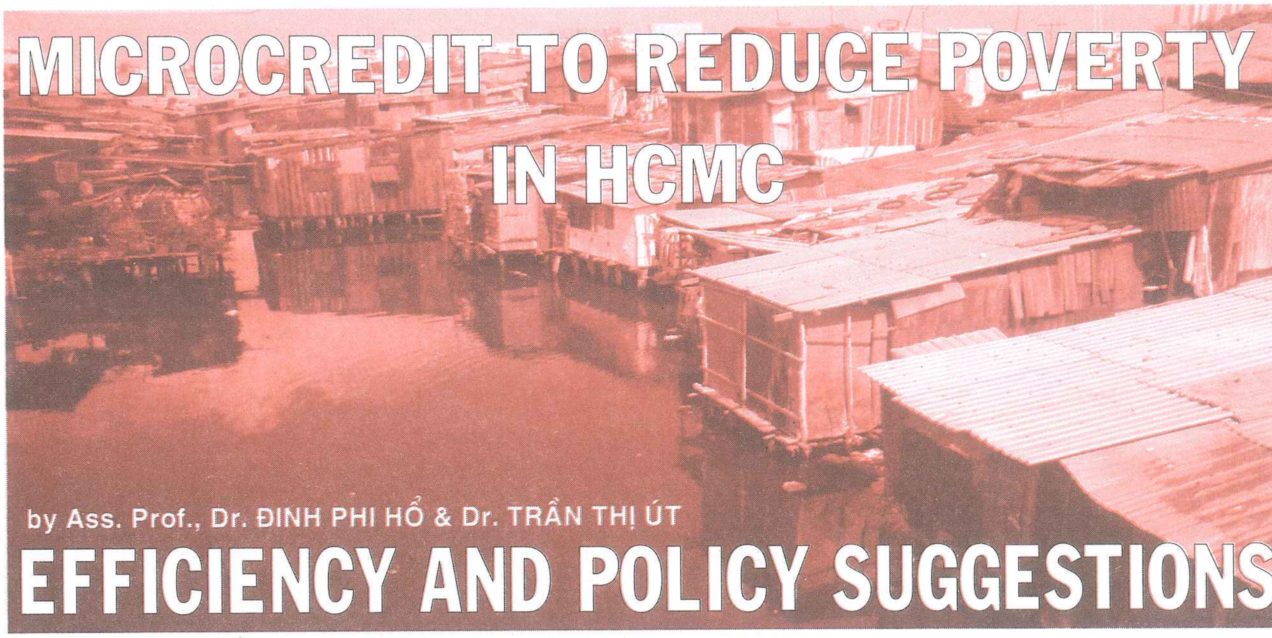

MICROCREDIT TO REDUCE POVERTY IN HCMC

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EFFICIENCY AND POLICY SUGGESTIONS

One of the greatest achievements in HCMC since the early 1990s has been its success in alleviation of poverty. Proportion of poor families reduced from 17% in 1992 to 1.34% in 2008 . The poverty can only be reduced by a system of solutions, not by a single measure. Both theories and realities show that, microcredit is an important instrument for reducing the poverty. Failing to summarize causes of success and arising problems is really inadequate for the effort to perfect the microcredit model. The article, therefore, discusses three aspects: (1) an overview of the microcredit for poverty alleviation; (2) factors affecting the efficiency of the microcredit; and (3) suggestion of coming problems to discuss and policies to be adopted.

1. An overview of the microcredit

The microcredit is the extension of small loans designed to help the poor and low-income earners to start their businesses and thereby improving their income. In HCMC, organizations engaging in this business include the HCMC Fund for Hunger Eradication, Poverty Alleviation and Employment (FHPE), Bank for Social Policy, Association of Peasants, Association of Women, and Capital Aid Fund for Employment of the Poor (CEP). These organizations could be divided into two groups based on the interest rates they offer: (1) suppliers of preferential credits; and (2) suppliers of commercial credits. The first comprises the Fund for Hunger Eradication, Poverty Alleviation and Employment, and the Bank for Social Policy that provide the poor with loans of very low interest rates. The second includes official microcredit institutions (such as Association of Women, and CEP), and private organizations that supply commercial loans.

Our survey of 1,216 households in Districts 6, 8, Hóc Môn and Cần Giờ (HCMC) in 2008 shows differences between the two groups of suppliers in interest rate, loan purposes, market share and lending ways.

a. Interest rate, loan size and maturity:

Formal microcredit offers loans whose maturity and size are much smaller than the loans of preferential interest rate and the ones supplied by private organizations. The interest rate, however, reflects the market interest rate and much lower than privately-supplied loans (13.6% per month on average).

Table 1: Features of microcredit interest rate (2008)

Feature	Preferential credit	Commercial microcredit	
		Formal microcredit	Privately-supplied credit
Interest rate (%/month)	< 0.65	0.65 – 2	> 2
Loan size (VND1 million/customer)	6-May	2.5 – 3.6	6-May
Maturity (month)	17-Dec	< 12	No maturity

Source: Đánh giá vai trò tín dụng ưu đãi và tín dụng nhỏ đến giảm nghèo ở TP. HCM (Estimate of effects of preferential credit and microcredit on poverty alleviation in HCMC)

As for privately-supplied loans, there is no maturity and borrowers have to only pay interest every month. Although the interest rate charged by the formal microcredit is higher than the preferential rate, 73% of respondents thought it was reasonable. This proves that the preferential rate is not a condition that makes the poor or low –income earners decide to secure loans. The size of the loan supplied by the preferential microcredit system is small and falls short of borrowers' expectation, according to 71% of respondents. As for the maturity, 75% of respondents considered it as appropriate.

b. Purpose and market share:

All suppliers of small loans worry about what borrowers use such loans for because this factor helps limit ineffective use of loans.

Table 2: Purposes of loan (2008)

Purpose	Use of loans by purpose (%)		
	Preferential credit	Commercial microcredit	
		Formal microcredit	Private lender/* (Relatives)
Production – Business	22	12	25
Trading	24 - 34	46 -57	17
Health care, education	18	13	17
Daily spending	14	18 – 22	30
Purchase of household goods/house repair	16-Dec	4 – 12	36*

Source: Đánh giá vai trò tín dụng ưu đãi và tín dụng nhỏ đến giảm nghèo ở TP. HCM

Table 2 shows that the borrowers use different sources of loans for different purposes. Loans from the preferential credit and formal microcredit systems are used for production, development of their businesses and trading, while privately-supplied loans are used for daily spending; and loans from relatives or friends are used for buying household goods and house repair. This shows the diversity of use of loans and logic choices of borrowers. No single credit institution can meet all of their needs. The private credit also plays an important role in satisfying borrowers' need for loans.

One question to answer is which kind of credit institution is playing an important role in the supply of loans to the poor. In the survey of 1,216 households, 51% get loans from the preferential credit; 18% from the formal microcredit and 31% from private lenders. This result shows that the preferential credit system plays the leading role in the supply of credit to the poor. The microcredit system, however, has its own foothold in the market and potentials for development because its interest rate is appropriate to the market.

2. Performance of preferential and commercial credit institutions

It's hard to quantify fully and exactly the socioeconomic effects of the microcredit system on the poor, because the credit is only one of various factors affecting improvements in income of the poor, and it doesn't mean that the poor can escape the poverty after securing loans from the microcredit system. That is why this section discusses three aspects of efficiency: (1) Do loans from preferential and microcredit institutions affect income of the poor? (2) What is the economic efficiency of performance of microcredit institutions? and (3) What makes a microcredit institution effective?

a. Effect of the microcredit on the income of the poor:

A linear regression model established to quantify relations between factors affecting the income of poor families is as follows:

Y = f(Xi) in which i varies from 1 to 7.

Table 3: Regression model

Variable	Description	Expected value
Y	Annual income of a household (VND1,000)	
X_1	Loan from preferential credit institution X1 = 1 (with loan); X1 = 0 (no loan)	+
X_2	Loan from formal microcredit system X2 = 1 (with loan); X2 = 0 (no loan)	+
X_3	Age of the head of household (year)	+
X_4	Education (grade 1 – 12)	+
X_5	Gender of the head of household X5 = 1 (male); X5 = 0 (female)	+
X_6	Trade X6 = 1 (with trade); X6 = 0 (no trade)	+
X_7	Size of the household (person)	+

Based on numerical data of 1,216 households in Districts 6, 8, Hóc Môn and Cần Giờ (HCMC) investigated in 2008 , the resulting model is as follows:

Table 4: Regression model

Variable	Coefficient	Confidence probability
X_1	0.091	0.006
X_2	0.262	0.000
LnX_3	0.123	0.060
LnX_4	0.016	0.000
X_5	0.050	0.126
X_6	0.162	0.000
LnX_7	0.619	0.000
Adjusted R^2 = 0.44		

Note:

- Independent variable: LnY
- F-test, t-test, Heteroskedasticity test and multicolinearity test are all performed.

Source: Đánh giá vai trò tín dụng ưu đãi và tín dụng nhỏ đến giảm nghèo ở TP. HCM

The results show that loans from the preferential and microcredit institutions produce effects on the income of the households. There is no denying that the microcredit system in HCMC has helped increase the income of poor families. In addition, education and use of loan by the head of the household also affect considerably the increase in their income. Analyses of the regression model show that small loans, when used for small trading businesses, have significant effects on the income of borrowers.

b. Economic efficiency of businesses supported by microcredit system:

One of important criteria for measuring the performance of a banking institution is the ratio of overdue debt and bad debt. Data of this ratio are gathered from reports by banking institutions and interviews with surveyed borrowers.

Table 5: Ratio of overdue and bad debt (%)

Source of data	Preferential credit		Microcredit	
	FHPE	Bank for Social Policy	Association of Women	CEP
Reports	9.75	1.3	1	0.99
Interview with borrowers	17.4	10.3	2.1	2.6

Note: Up to the end of 2007

The bad debt ratio in the preferential credit estimated by borrowers surveyed in February 2008 is higher than the one reported by banking institutions. In spite of the difference, the Table 5 shows clearly that performance of microcredit system is much higher than the one by preferential credit system.

One question arising from this fact is what makes the microcredit system operate better than the preferential credit one when the interest rate offered by the former is higher the one by the latter.

Firstly, both theories and realities in developing countries show that the preferential rate that is lower than the market rate is not an effective and sustainable instrument for supporting the poor. The poor can't exist in the market without this source of credit and this rate fails to encourage them to use the loan effectively for their businesses. Low interest usually leads to passiveness and heavy reliance on the debt writing off policy for the poor.

Secondly, performance of banking institutions shows that low-income earners can employ effectively the loan when they can get access to formal source of loans of commercial rate, such as commercial banks. At present, they can't access such sources because they can satisfy conditions for loans (assets for mortgage or feasible business plan for example).

Thirdly, the microcredit institutions can overcome asymmetric information by retrieving debt on a periodical basis, encouraging self-supervision by members of groups of borrowers, identifying borrowers with poor track record and enhancing sense of responsibility of bowers by voluntary and compulsory saving mechanism.

3. Suggestions on policies

To make the microcredit system more useful and helpful for the poor, policies must be centered on the following problems:

- A track to a single rate of interest on loans for the poor based on the market one.

- Better lending operations, capital management and debt retrieval by preferential credit institutions that are not under the financial-banking mechanism.

- Encouragement in forms of tax incentives, land rental or favorable procedures, to all private persons and organizations who want to engage in the microcredit supply.

- A close relation between the Bank for Social Policy and commercial banks with the microcredit system in which the microcredit system can get access to more sources of finance with a view to supply bigger loans to more classes of borrowers.

- Better support from the State, such as facilities, training expense, and favorable legal framework, that help microcredit system get access to local authorities and civic organizations, especially in suburbs, and rural and remote areas■

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