69460

The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Vietnam's Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy

Public Disclosure Authorized

Author's Note

This paper discusses the role of the postal network in expanding access to financial services in Vietnam. It reviews the public postal operator within the postal sector and within the broader context of the communications sector. The roles of the Vietnam postal network and post bank are also reviewed from the perspective of the financial sector development, with particular focus on payments systems development and micro finance.

This paper was prepared with desk research in 2004. Field visits were not scheduled.

While this country case on Vietnam can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (*Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam*) and 5 regions (*Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa*).

Glossary of Abbreviations and Acronyms

ATM	automated teller machine
BIDV	Bank for Investment and Development of Vietnam
CBPS	Commercial Bank Payment System
EFT POS	electronic funds transfer at point-of-sale
Eximbank	Vietnam Export and Import Commercial Joint Stock Bank
IBPS	national inter-bank payment system
ICB	International Competitive Bidding
Incombank	Industrial and Commercial Bank of Vietnam
ITDB	Informatics Technology Department of the Bank (SBV)
JSB	joint-stock bank
Kampo	Japan's postal savings institution
M2	total deposits as a percentage of all physical money (coins and currency)
Maritimebank	Vietnam Maritime Commercial Joint Stock Bank
MFI	microfinance institution
MOF	Ministry of Finance
NDAF	National Development and Assistance Fund
NPC	National Payments Council
PCF	Peoples' Credit Fund
PPC	Provincial Processing Center
PTT	Provincial enterprise for Post, Telegraph and Telephone Service
ROSCA	rotating savings and credit association
RSHBs	Rural Shareholding Banks
SAPS	settlement account processing system
SBV	State Bank of Vietnam
SOCB	state-owned commercial bank
SOE	state-owned enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunications
UPU	Universal Postal Union
UNDP	United Nations Development Program
USD	United States dollar
VBARD	Vietnam Bank for Agriculture and Rural Development
VBP	now known as the Credit Policy Bank
VDC	Vietnam Data Company
Vietcombank	Bank for Foreign Trade of Vietnam
VND	Viet Nam dong

VNPT	Vietnam Posts and Telecommunications
VPS	Vietnam Postal Service, Vietnam Post
VPSC	Vietnam Postal Savings Corporation

TABLE OF CONTENTS

Summary

SWOT Analysis of Vietnam Postal Financial Services

Strengths	**Opportunities**
▪ Since 1999 going through a rapid and successful expansion; financial services already present in 920 post offices (of 2,946), as of 2004. This is effectively the second largest network for financial services in Vietnam. If/when all post offices are involved it would be the top network providing access to financial service. Post offices are located both in areas where many bank branches are present, as well as in areas where only informal channels and agents act as competitors. ▪ Mobilizes small deposits with a low minimum deposit requirement and has nearly 400,000 savers with a total balance of VND 3.8 trillion. Would rank in the 10–15 largest financial institutions in Vietnam. ▪ Processes a considerable volume of payment transfers per year (money orders, pensions, electricity bills) and is setting up new services (debit cards, payroll). ▪ Is perceived as a non-bank by the population; there is a high level of personal trust in postmasters/post offices in rural areas. ▪ Has no non-performing loan portfolio and has never defaulted in payments to depositors.	▪ Postal banking offers the potential to increase savings propensity, savings, and provide banking services to the rural poor. ▪ With proper marketing and improvement in efficiency, postal banking should become a much more significant force in retail banking and could be a major force in the transition from cash to cashless small-value payments. Opportunities present to develop into a channel for remittances, savings, credit. ▪ In the medium term, products, such as life insurance and trust units, could potentially be sold through the post offices, linked to existing savings and payments accounts. ▪ Transfer operations can grow quickly (if tech-nology infrastructure is available) to include direct credit transfers (salaries) into personal accounts and chipcard technology for small-value payments. ▪ In the longer term, synergies could be achieved if postal network were to develop ICT, Internet access, and a platform for e-government and e-commerce (fulfillment). ▪ Post office could become the country's first chain of convenience stores providing basic financial services, communications, and retail trade. ▪ Vietnam has a relatively large number of medium-size banks with small networks, that might be a partner for VPSC
Weaknesses	**Threats**
▪ Relationship with VPS for use of postal network is not transparent. ▪ Reporting and governance framework is not transparent and not compliant with the Law on Credit Institutions; hence cannot offer lending. ▪ Not connected to interbank payment system. ▪ Coverage to all post offices progresses slowly due to investment requirements in IT and HR, and training. ▪ Integration with VPS payment services will absorb management capacity. ▪ Legal framework limits commercial flexibility and asset management. ▪ Management controls only basic marketing, banking, and technology skills; risk control and management accounting virtually non-existent. ▪ Progress in computerization has limited functionality; is in early stage only. ▪ Has inefficient staff and operations in post offices; staff has limited training, and there are no performance incentives for staff or management.	▪ Postal reform strategy has not been determined—relationship of VPSC with the postal network may come under pressure as a result of separating Post from Telecommunications and subsequent need to boost revenues. Current position of VPSC within VPS, without banking license, is a risk to sound continuity of postal savings. ▪ Regulatory reform of VPSC requires support from Ministry of Finance, which currently funds NDAF and government bonds. ▪ Large part of the operation is paper-based, manually processed, lacking the support of computerization, oversight and MIS.

1—Postal Sector Development

Origin, Data, and Features of the Postal Sector in Vietnam

Vietnam’s postal services date back to when the French ruled Indochina and set up a mail system. The lengthy conflicts since Vietnam’s proclamation of independence in 1975 have had a deep impact on the postal services and their infrastructure. The unification of Vietnam under socialist rule gave the postal service the opportunity to restore and rehabilitate itself into a single postal network. From 1987 to 2002, the Vietnam Postal Services renovated its operations and expanded its network to ensure that people had access to basic communications facilities. Considering that 80 percent of the Vietnamese (i.e., more than 60 million people) live in rural areas, the dense postal network truly can link the nation.

The Vietnam Postal Service provides a high level of service with reportedly 99.83 percent of the population receiving mail at home, six days a week. In urban areas, Vietnam Post provides mail delivery twice daily. This is a huge benefit for the business sector, but also very costly. Although no research is available on the quality of service of the mail delivery, it is believed to be good in general. Various independent publications and web sites focused on the international business sector recommend the use of Vietnam Post; in particular its express mail service is praised.

Vietnam Postal Service has a **uniform tariff**—this is important for its community service—which allows rural users to pay the same price as urban users of mail. The average number of citizens served by each post office is around 6,350. This is somewhat lower than in developed countries, but better than that found in many developing countries. Moreover, post offices in general are located within a radius of 2.8 km, which situates the **postal network close to its users**. The postal network is state-owned and offers both postal and telecommunications operations. It has rapidly expanded during the past years, including new outlets, such as kiosks.

The mail-per-capita demand in Vietnam is not known. Data on the primary mail flow (letters) are not reported to the Universal Postal Union or other entities, but it was estimated to be in the range of 7–12 items in 2002. This mail volume includes the delivery of 285 million newspapers.

Although Vietnam Post has recorded impressive achievements, it has identified—in its long-term plan to 2020—objectives for further development. These objectives deal largely with ongoing and anticipated changes in the postal sector and address various weaknesses and problems:

- Institutional and regulatory reform
- Commercialization and diversification (financial services)
- Partnership building with local and international institutions
- Human resources development

One of the key issues for Vietnam Post is separation from the Vietnam Post and Telecommunications Corporation (VNPT), which acts as a broadly diversified conglomerate in the field of communications. VNPT claims to have 90 percent of the market share in the postal, telecommunications, and information technology (IT) sectors.

The entities within VNPT have different structures, ranging from incorporated (joint stock) companies to state enterprises (non-productive units), and PTTs (provincial enterprises for post, telegraph, and telephone services) that provide the postal and telecommunications services locally. VNPT is 100 percent owned by the government, with the responsible Ministry of Posts and Telematics also in charge of regulation, policy, and management. The Vietnamese Parliament, too, is involved in operation and management decisions of VNPT and sets tariffs. **Vietnam Post has limited managerial autonomy** to pursue changes, as well as limited authority to enforce changes. It is dependent on VNPT and the Ministry, and it has no direct control over its operations which are regionally organized, together with telecommunications.

VNPT resembles a state holding company that dominates the entire communications sector. It is involved not only in postal, telecommunications, and IT operations, but in manufacturing postal/telecommunications equipment, construction, consulting, building design, as well as in human resource training and trading (import and export) postal/telecommunications equipment. The individual companies in these activities have their own management and accounting, and follow government accounting principles. **There may be intra-company debt relations between the entities of the VNPT holding company**.

Separating Vietnam Post from VNPT is a target for the next few years. As examples from countries of the former Soviet Union have shown, the process of restructuring and transforming the sector is complex and needs careful preparation to assess the actual value and viability of the involved entities. Vietnam will be able to draw on the lessons from other countries that unwound their state communications industry into a diversified, competitive sector. In Vietnam, the ownership allocation of the postal network should be critically reviewed. Currently the postal network is made up of provincial enterprises, the PTT network, which is essential in providing rural access to telecommunications and mail.

Vietnam Post itself is also organized in subsidiaries, business units, and joint ventures—including relations with the 61 provincial entities. Due to this structure, several of the subsidiaries have been able to develop their business rapidly (e.g., express mail, data post, logistics company.); it is a managerially decentralized postal operation, with possibly a high degree of autonomy within separated entities. In building an effective postal operator, a higher degree of centralization may be required.

VNPT is regulated by the Ministry of Posts and Telematics, one of the ministries under the auspices of the prime minister in Vietnam. The Ministry of Posts and Telematics—whose function is drafting acts and policies, setting strategies for all posts and telecommunication activities, providing licenses to operate, open, or close national and international posts and telecommunications services—was reorganized from the Directorate General of Posts and Telecommunication in 2002. There are also other state-run companies parallel to VNPT, such as Viet Tel and Saigon PostTel, etc., but they have very limited and specialized market positions.

VNPT has a “board of management,” the highest decision-making unit, consisting of a board of directors and an inspection committee, in addition to so-called “member units,” such as non-productive units, joint stock companies, their own companies or enterprises (member companies), and 61 PTTs.

VNPT has internal departments (so-called “functional divisions”) under the control of its board of directors. Functional departments consist of the following 15 departments and organizations: administration; VNPT representative office (in Ho Chi Minh City); planning; finance and accounting; investment; science, technology, and industry; international co-operation; postal; telecommunications; personnel; marketing; security; investigatory; audits; and rural post and telecommunication development. Their own companies, the “member companies” are Vietnam Telecom National, Vietnam Telecom International, Vietnam Data Communication, Vietnam Telecom Services Company, Vietnam Mobile Telecom Services, Vietnam Postal Service (VPS), Vietnam Postal Savings Company (VPSC), Vietnam Stamp, and National Newspapers Distribution.[1]

Vietnam Postal Service has 26,000 full-time employees and 5,500 part-time employees. It is assumed that the staff of post offices is included in these figures. A very rough subdivision of staff would put 18,000 in collection and delivery of mail, parcels, and newspapers, and about 12,000 at postal counters to sell stamps, collect parcels, and process payments and savings.

[1] Other companies under VNPT are: Posts and Telecommunications Finance; Telecommunications Manufacturing and Research Enterprise 1; Telecom Manufacturing and Research Enterprise 2; Vietnam Telecommunications Equipment Company; Posts and Telecommunications Construction, Investment, and Development Consulting Company; Posts and Telecommunications Equipment Import-Export Service Corporation; Posts and Telecommunications Material Supply; Posts and Telecommunications Engineering; Posts and Telecommunications Construction; Postal Construction Material Company; Post and Telecommunication Equipment Factory; Printing Manufacturing; and Stamp Manufacturing. Joint venture member companies are: Vietnam-Korea Exchange, Ltd.; VinaDaesung Cable; Optical Fiber-Cable Manufacturing; Alcatel Network Systems Vietnam; Fiber Optical Cable, Ltd.; Telecommunications Equipment, Ltd.; VNPT-FUJITSU Telecommunication Systems, Ltd.; and VNPT-NEC Telecommunication Systems, Ltd. Joint-stock companies are: Cable and Telecommunications Material Joint-Stock Company; and Posts and Telecommunications Joint-Stock Insurance Company (handles non-life insurance products).

The post office network hierarchy is made up of three levels: PO Level 1, PO Level 2, and PO Level 3. There are 64 Level 1 post offices, consisting of 3 zone centers (north, south and central), which are mail sorting centers, and 61 province or city mail centers. These 64 offices are the backbone of the mail logistics system in Vietnam. They are connected by air and trucks routes, with no dependence on railways.

The other post office levels represent the "retail network" of Vietnam Post. There are 542 Level 2 post offices (similar to district post offices), and 2,404 Level 3 post offices (i.e., the postal outlets or postal stations). Below this hierarchy, the VNPT has 4,100 postal agencies and postal-telecom-cultural stations in rural areas, and 340 multi-service agencies mostly located in cities.

Postal Services

Breakdown of VNPT Revenues, 2002

Type of Service	Revenue Share in %	% Growth Rate
Domestic letter post	18.0	26
Newspapers	10.0	- 15
Express	16.8	13
International	20.0	3
Money orders	14.5	+
Savings	8.70	++
Other (hybrid, logistics)	11.0	+

Data: VNPT, UPU

The **revenues cover about 40 percent of costs**. This figure may be underestimated, as it is not known to what extent cost for amortizations and other provisions are included under Vietnamese government accounting standards.

Vietnam Postal Service losses have been chronic: they have substantially increased from USD 30 million in 1999 to USD 75 million in 2002. The accumulated losses over the past five years are estimated at more than USD 200 million. Vietnam Post has an ambitious policy objective to turn itself around and become a profitable enterprise, but this would require in-depth analysis and diagnosis of its current financial condition and the preparation of a business plan based on product and customer profitability. This will be far from easy, as cost and asset allocation for the postal services still needs to take place. The objective is also challenging given the public service mission of Vietnam Post.

Becoming profitable would need to be supported by a larger degree of commercial freedom. Postal tariffs are low, about USD 0.05 for a letter up to 20 grams, which is unlikely to cover associated costs of restructuring, and the achieved rapid growth in mail volume may actually increase losses. A turnaround implies an increase in postal rates and a lower level of service. (A second delivery round in cities would not be affordable, for example.) The size and structure of the postal network also needs review in order to decrease costs or make them more flexible. One solution might be to transfer ownership of post offices to private agents as a franchise.

Investments have been made in the postal network, but in the past years quantity has prevailed over quality. The network expanded rapidly, with more than 900 postal stations added between 1999 and 2002, outpacing the growth rate of business. With business volumes for the network insufficient to cover costs, the main driver for expansion seems to have been providing better outreach for services, and not modernizing operations. Most post offices are not equipped with ICT or even a stand-alone computer, and still rely on manual, paper-based processing.

According to the long-term plans, investments will be made to install ICT in post offices, which eventually will help to improve access to Internet. Details about sources of funding and viability are presently not available. At this stage, investments are determined on a year-by-year basis by the ministry, in accordance with the afore-mentioned plan.

Post offices provide access to telephone services. Vietnam has about 2.6 million fixed-line connections, or 32 fixed-line subscribers per 1,000 inhabitants. In addition, nearly one million mobile phones are in use. Vietnam is making a strong effort to increase the number of telephone connections rapidly, with a sustained growth rate of more than 25 percent per year. In practice, though, most villages and households have no phone and must go to the post office to make calls.

The Ministry of Post and Telematics (MPT) has a policy for ICT, to improve the telecommunications and postal sector, access to the Internet, and e-government. The Ministry receives assistance from the World Bank and several bilateral programs, e.g., Korea. There were about 7.5 personal computers per 1,000 inhabitants in Vietnam in 2002. The number of home Internet users is estimated at less than 400,000 or less than 2 percent of all households. Access to the Internet is relatively expensive, and not very attractive to most Vietnamese given the relatively small number of Vietnamese-language web-sites. E-commerce does not exist yet.

According to an announcement by the MPT, **the postal network is likely to be the basis for rolling out an e-Vietnam program.** The post offices would provide electronic and Internet access to many households, which are unlikely to have a PC or telephone line any time soon. An upgraded ICT infrastructure in post offices would also facilitate delivery of financial services and play a role in the promotion and fulfillment of e-commerce.

The roles of the postal network need to be taken into account when its services are separated from telecommunications. A separation could spur the commercialization and effectiveness of the mail business, and it might be considered fair to let the telecom operators maintain an economic and financial responsibility for the postal network as long as there is no alternative access to these services.

Also the relationship between VPSC—the postal savings corporation—and the postal network would need to be reviewed prior to separating Vietnam Post from VNPT. Lessons from other countries show that a dense postal network cannot be (economically) maintained with just mail services. In fact, from a strict business point of view, the mail operator would not need the postal network, as its logistics infrastructure with mail processing hubs could be sufficient. But conversely, the postal savings and telecommunications/ICT operators cannot exist or develop without a dense postal network. Vietnam would therefore have to engineer the break up of VNPT in such way that the postal network can be sustained as the basic infrastructure for access to financial services ***and*** communication services.

The Role of the Postal Network in Financial Services Delivery

The Vietnam Postal Savings Corporation, VPSC, is one of the youngest postal savings institutions in the world. Initial steps to establish it date from early 1990s, it began operations started in 1999, and has rapidly developed since then.

Since 1993, Japan—via bilateral assistance programs—has intermittently provided expertise and training from its postal savings institution (Kampo) to assist in the set-up. The assistance ranged from support in drafting the regulatory and institutional framework, designing the products and systems, designing the organizational structure, and training key staff (in Japan). VPSC's business model resembles Kampo in certain key features, and differs in others. Since 1999, as VPSC's development progressed, these differences have become more apparent.

VPSC was established via special decree by the prime minister (No. 215 of November 1998) as a **subsidiary company of VNPT** to provide postal savings services to the public in Vietnam, and actually began providing services in mid-1999. VPSC, however, is not licensed as a bank under the Law on the Credit Organizations. The Ministry of Post and Telecommunication of Vietnam regulates the postal savings service, with the consultation and approval of the State Bank and the Ministry of Finance. The owner and regulatory functions of the VPSC are essentially combined within the VNPT. The State Bank of Vietnam is reportedly responsible for monitoring deposit interest rates, money remittances, and the safety of all the funds of the postal saving service system, and assisting the VNPT in training staff members of post offices participating in the postal savings service system.

Deposits in VPSC are implicitly presumed to be guaranteed by the state, and the investments are made in state assets only. The registered capital of VNPT was VND 50 billion (about USD 4 million). VPSC is also presumed to be a company (a commercial entity) within the VNPT structure, which is state-owned.

The Vietnamese government's rationale for setting up the VPSC was very much in line with the ideas behind the "savings for national development", i.e., pooling small deposits and channeling them to government funds which are used to finance the (long-term) development of the country. In the case of VPSC, the postal savings collected at post offices are pooled and invested mainly in the National Development Assistance Fund (NDAF) owned by the Ministry of Finance which lends mainly to long-term projects relevant to national development.

VPSC became an official member of the World Savings Banks Institute[2] in 2002. VPSC's membership in this international body gives it access to bank-specific publications, literature, conferences, and training sessions to augment its development. Meetings with overseas postal savings banks also provide the opportunity to exchange experience and ideas.

VPSC started its operations by launching simple savings products, such as passbooks and certificates. As in some other countries (e.g., Czech Republic and Brazil), beginning with a limited range of products appears to be effective for building a database of customers to whom other products can eventually be sold.

There are now **three types of postal savings products**: time deposits, utility deposits (to install service), and standard deposits. Initial savings deposits—VND 634 billion in 1999—soared to VND 3.166 billion in 2001, and VND 3.800 billion in 2003, representing a market share of more than 1 percent of total M2, including corporate deposits. This is an impressive result. Newspaper articles in August 2004 mentioned that VPSC ambitiously aimed to hold deposits of VND 10 trillion by the end of 2004. The number of postal savings accounts reached 381,735 at the end of 2003. According to the State Bank data, this is 42 percent of the market covered by credit institutions. It suggests that credit institutions and banks have only recently, and on a limited scale, begun marketing individual accounts.

The number of post offices handling postal savings increased from 202 in 1999 to 710 in 2002, and has been gradually increasing since then. VPSC announced that it would expand its network to 920 this year and be present in 52 of the 61 provinces and cities.

Post offices comply with several standards outlined by Vietnam Post and VPSC. Each must have five staff members, including a head and one supervisor, and one computer, which limits the expansion rate. VPSC operations at the post offices are handled by post office staff, not VPSC staff, such that VPSC uses only about 10 percent of the counters of the entire postal network. There is room for VPSC to increase its presence and activities considerably, especially if it involves more post offices.

VPSC has launched payroll services, providing accountholders with debit cards. This is a very useful product, but not yet widely used in Vietnam. Focused on individuals, the number of these accounts currently stands at 26,000 in only three provinces, with a total amount of VND 86 billion (USD 5 million). In addition, 77 post offices are connected on-line in a pilot program to offer payroll services to specific companies and to sign up employees as clients of VPSC. This service is convenient for the individuals, but also efficient for the company. Unfortunately, VPSC is unable to offer the company other banking services, such as deposits, overdrafts, commercial payments, and loans.

The number of non-cash transactions processed by VPSC reached 812,173 in 2003, representing 3.6 percent of the total volume of Vietnamese non-cash transactions (excluding ATM operations).

In 2003, the Ministry of Posts and Telematics made the decision **to integrate the postal payments service of Vietnam Post into VPSC**, beginning in 2005. It appears to be a sensible step to consolidate all financial services under one roof, create synergies and greater transparency, and avoid potential frictions between the payments services of the post and the payments and savings services of VPSC.

[2] The World Savings Banks Institute is a platform to promote the interests of savings banks.

Money Orders and Money Transfers

There are three types of domestic money orders offered by Vietnam Post:

- letter (standard) money order;
- telegraphic money order; and
- express money order.

There are two types of international remittance services: international money orders through 11 postal systems (including France, Switzerland, Japan and Canada); and a money transfer service as an agent of Money Gram—an international remittance company. A connection to the Eurogiro network for international postal payments is under consideration.

In the case of domestic money orders, the volume of transactions increased from 4.3 million in 2000 to 4.9 million in 2001, and the amount of these transactions increased from VDN 9.5 billion in 2000 to VDN 10.1 billion in 2001. By contrast, the volume of international money orders through MoneyGram agents decreased from 34,291 in 2000 to 30,164 in 2001. The amount of these international money orders and remittances also declined from VND 190.5 billion in 2000 to VND 173 billion in 2001. This trend is the opposite of the market trend which shows fast growth in remittances. Causes for this decline might be the **limited number of post offices with international capability and inadequate marketing.** A considerable opportunity for the postal network appears to be underutilized.

The VPSC has agreed within VNPT to implement the following services as part of their strategy:

- Pension payments
- Life insurance
- Postal checks
- Tax payments
- Telephone bill payment
- Electricity bill payment
- Water bill payment

This is a basic expansion of current services and could be in operation within the next 2–3 years. In this way, VPSC is positioning itself as the entity for deposit mobilization and (cash) payment processing.

Organizational Structure

Under the supervision of a director and deputy director, the VPSC organization includes specific internal divisions at headquarters, such as human resources and administration, accounting and finance, research and development, business planning, payments, investments, postal savings, and auditing. It is responsible for a unique post office (located in the VPSC headquarters building) which only provides postal savings services, and a branch office in Ho Chi Minh City.

VPSC headquarters centrally manages all postal savings transactions of the provincial and district post and telecom, and post offices providing postal savings throughout the country in conjunction with VNPT. Postal savings services are currently provided in 30 provinces and cities (of 61 provinces and cities) in Vietnam, and are being expanded to 52 provinces and cities.

VPSC can determine its own interest rates on deposits mobilized from customers, in compliance with interest rates on deposits in private financial institutions. Postal savings funds deposited by the public are usually re-deposited by VPSC in the NDAF as long-term loans at one-year, two-year, three-year, and five-year maturity options. **The annual amount of funds to be transferred to NDAF is determined by the Ministry of Planning and Investment**. The interest rates for these funds are decided in negotiations between NDAF and VPSC.

The interest rate for loans, namely the sum re-deposited in NDAF, is determined by the Ministry of Finance, based upon coupon rates of government treasury bonds with similar terms.[3] The money invested by VPSC in NDAF amounts to about 10 percent or less of the total funding base of NDAF. For NDAF, the cost of funding through government bonds seems lower and more efficient than through VPSC. This should highlight the necessity of analyzing or evaluating the rationale of VPSC's funding NDAF and looking at alternative options for VPSC.

Network Expansion of Postal Savings

VPSC launched its services at 240 post offices in 61 provinces and cities in 1999. By the end of 2002, VPSC had services in 709 of about 3,000 post offices, and in 920 at 2004 year end. In addition, 78 post offices were connected to the individual savings account service and 100 post offices were computerized. In 2002, VPSC offered these products and services:

- Time savings: 3 months, 6 months, 1 year, and 2 years
- Collection savings: 6 months, 1 year, 1.5 years, 2 years
- Individual savings accounts: 26,000 accounts
- Payroll service to 43 companies with the total transfer sum of VND 21 billion (USD 1.4 million)

Computer Network

In order to achieve such objectives as providing higher-quality service and universal deposit and withdrawal services at different locations throughout Vietnam, **further development of VPSC, survival in the increasingly competitive financial market, and an on-line network was mandatory** and was constructed in two phases. VPSC developed its own software, in 2001, in cooperation with Getronics. They established a data-processing center in Hanoi and launched an individual savings account service for customers in 2002. A network center was established in Ho Chi Minh City a short time later to offer similar services. The first phase of constructing the computer network (pilot program) was finished by 2002, and roll-out to the public continued throughout 2003 and 2004. VPSC goals for the computer network were capacity to manage three million accounts and some 500,000 transactions in a regular time period (per day).

The computer network centers in Hanoi and Ho Chi Minh City were equipped with data servers (with brands such as Cluster, Unix, and Oracle), as well as web servers, e-mail servers, network management servers, and so forth. For the network, Public Switch Telephone Network and X-25 were utilized as communication circuits. Meanwhile, the on-line system for the post offices was equipped with a passbook printer, a personal identification number (PIN) pad, and other network equipment. Services introduced via the computer network were said to be well designed, not only for the basic savings products and services, but for new, future services.

Phase 2 of constructing the computer network will include expanding the network (bringing more post offices on-line), introducing telephone and mobile banking, and developing chip cards.

Business Performance

In 2002 VPSC managed more than 276,656 passbooks and certificates with a balance of deposits reaching VND 3.8 billion (USD 248 million). By comparison, the total balance of the funds transferred to NDAF stood at VND 3.8 billion (USD 243.8 million).

[3] For example, in December 2003, the deposit interest rate was 7.8 percent, with the return interest rate set at 7.0 percent. Such negative differentials spelled trouble for the operational management of VPSC. The below-market rate compensation of NDAF is likely to continue to burden VPSC's development, to impose risks in asset/liability management and to negatively influence the competitiveness of the products.

VPSC Revenues and Expenditures, 2002

	Amounts (VND billion)	Amounts (USD million)
Total Revenue	221.3	14.4
Total Expenditure	219.6	14.3
Operational Expenditure	15.6	1.0
Total Amount of interest paid	204.0	13.2
Profit (or Loss)	1.7	0.1

VPSC estimated that the 2003 results will show some loss due to a negative gap between the interest rate offered to customers and the return interest rates on funds re-deposited in NDAF. More recent data were not available. Although it is not exceptional for savings banks' greenfield operations to show operational losses in their first 2–3 years of start-up, the 2002 results do not bode well for VPSC's financial sustainability. Financial institutions are supposed to record profit and to be able to re-invest part of their profit into innovation and development. **VPSC's results seem to provide very little room to self-finance its modernization**.

A component of the operational cost relates to the compensation of VPSC to Vietnam Post for utilizing the postal network. Reportedly, the fee per transaction is VND 1,800 plus 0.08 percent of the value. Although a breakdown of costs at each post office is not available, this appears adequate to cover the directly-associated labor cost per transaction.

It is **unclear what contribution VPSC makes toward the infrastructure and its development** (e.g., investments to upgrade computerization and security at post offices, or training postal staff). Without such a contribution, **it appears as if Vietnam Post subsidizes the operations of VPSC**. Government limitations on VPSC's ability to determine and self-finance its own investment strategy toward the postal network make it dependent on government priorities for improving the post offices.

It should be a point of concern that VPSC could operate without attaining adequate profit levels and with a favorable cost treatment from Vietnam Post. This would not enhance the level-playing field with other deposit-taking institutions in Vietnam.

VPSC's Assessment of Its Business

The Vietnam postal savings system has proved to be one of the **most efficient capital-mobilizing channels of the Vietnamese government**, by effectively utilizing the nationwide postal network in Vietnam. It is a mark of its success that the Vietnamese people have trust and confidence in VPSC as well as in postal savings services.

Despite the above positives, **VPSC sees several limiting factors**. The number of post offices handling postal savings services is still limited. The amount of money collected through postal savings network is still relatively small. The manual operation of the system and the limited types of services provided make postal savings facilities less attractive when compared with commercial banks.

VPSC itself recognized that it **offers a limited range of services**. It needs to overcome the structural obstacles to determining profitable interest rates offered to customers versus the return interest rate on loans to NDAF. Its investment targets and capital are limited because VPSC is not allowed to freely invest money mobilized from the public. On top of this, VPSC lacks experienced personnel.

Strategies

VPSC developed a plan for 2003–05, with targets and goals to achieve:

- Transfer VND 1.800 billion to NDAF
- Expand the current network of postal savings account service to 61 provinces and cities
- Offer new types of savings to the public

- Provide payment services to the public
- Research such modern financial services as telephone payment, e-commerce, Internet banking, chip cards, and life insurance

VPSC and VNPT have already applied for approval of the State Bank to offer payment services. In these discussions with the State Bank, it has floated the idea of **providing microloans through the postal network**.

Risks

In its current environment, VPSC appears to be exposed to a range of risks, and what measures it intends to take to mitigate these risks are not clear. A number of risks have been identified:

- ***Interest margin risk***: There is substantial disequilibrium between client deposit interest rates and terms and the assets held at NDAF and in government bonds, leading to interest-rate and interest-term risk, and risk of negative interest margin income.
- ***Market and sustainability risk***: As a wholesale funder more or less confined to government entities (in particular NDAF and government bonds), VPSC is bound to offer client interest deposit rates which are not competitive and/or to accept lower profitability levels. Not allowing VPSC to self-finance its development and build reserves undermines the market as well as the economic sustainability of the VPSC.
- ***Liquidity and operational risk***: Because of the periodic, manual, and paper-based settlements between the post offices providing the postal savings and the VPSC headquarters, there may be a substantial lag between the deposits and disbursements made at post offices and the recording and management of these funds at the VPSC headquarters. These procedures increase the chances of client and staff fraud.
- ***Operational risk***: Funds are lacking to upgrade to modern technology and train skilled staff. Paper-based, manually-processed business procedures are more open to fraud and delay of information needed to manage VPSC's financial position.
- ***Settlement risk***: There is settlement risk on payments to and from other banks because VPSC is not connected to the Interbank Payment System and has to deal directly with a large number of bank branches.
- ***Regulatory compliance risk***: VPSC's regulatory environment (regulation, supervision, reporting) does not appear to be transparent, and it may not be compliant with the instructions from the various regulators involved.
- ***Loss risk***: VPSC is an affiliate of Vietnam Postal Service, which is said to be a heavily loss-making operation and which will not be separated from VNPT for the next few years. Within this corporate governance setting, VPSC is subject to Vietnam Post management. The current financial relationship between VPSC and Vietnam Post is not fully transparent. In particular, it appears that Vietnam Post subsidizes VPSC, although Vietnam Post may be using VPSC's liquidity as own working capital. Pressure to increase the cost compensation from VPSC to Vietnam Post will happen only when Vietnam Post is separated from VNPT. In addition, it is unclear if and how risk is mitigated, whether VPSC's client deposits would be used to finance or cover the postal operational deficit.

In the current constellation, VPSC is highly dependent on its relationship with the Vietnam Bank for Agricultural and Rural Development (VBARD). In addition to VBARD, which has computerized about 115 branches (out of 1,900), VPSC with the post offices could provide low-threshold access to basic financial services in rural areas and under-served urban communities. However, this would require a clear institutional framework for VPSC, so it could operate through the post offices and to finance improvements to the business processes and technology in the post offices.

2—Vietnam Postal Financial Services in Market Perspective

Since opening up to the world in the late 1980s, Vietnam has embarked upon a long-term development strategy to modernize its economy and to integrate itself into the international community. Extensive efforts and actions on many fronts supported the country's transition from a centrally-planned economy to a market-oriented one. One of the most important sectors to be developed and modernized was the country's financial sector to support economic growth and the smooth transition to a market economy. The government's development strategy for the financial sector was formulated around the following objectives:

- Developing a market-based monetary system
- Fostering efficiency and competition in the financial sector through equal treatment of all participants and through modernization of banking systems
- Promoting public confidence in the banking system

The government tackled areas of immediate concern first, keeping to the philosophy of a gradual, and sustainable reform process with broad consensus among stakeholders.

Access to the Payment System

In the early 1990s, the payment system needed improvement to offer effective and efficient service to the banking sector. For example, in the absence of non-cash payment instruments, cash was the predominant means of payment in Vietnam; without electronic transfer of funds, government payments between agencies, as well as other expenditures, were handled outside the banking system; and payroll payments were done in cash.

Under a World Bank program, **the payment system has been substantially improved**. **A national inter-bank payment, clearing, and settlement system (IBPS) has been implemented.** This IBPS has modules for large-value payments as well as for small-value credit transfers. The IBPS was designed to handle intra- and inter-provincial domestic inter-bank payments in Vietnamese dong, with a currency conversion facility for non-dong-denominated payments.

Settlement banks have direct access to the IBPS, with a single centralized settlement account at the State Bank of Vietnam and the IBPS interacted with the settlement account processing system. The State Bank established the criteria for settlement banks to participate in the IBPS, such as financial strength, conformity with technical standards, and risk management ability. A bank without a settlement account could participate indirectly through a correspondent relationship with a settlement bank. The IBPS was designed to allow access by settlement banks through six provincial processing (clearing) centers and through the banking centers in Hanoi and Ho Chi Minh City.

Any commercial bank that met the participation criteria set by the State Bank could participate. VPSC (and Vietnam Post) is not a commercial bank and does not meet the criteria, and therefore has to partner with settlement banks. For VPSC to play a role in bulk small-value payments, exclusion from the IBPS implies inefficiencies, delays, and additional risk in settlements. Although VPSC would seem to be at a competitive disadvantage with banks that already have implemented computerization for payments processing, few to none of these banks are set up to process bulk volumes of payments. **VPSC could leverage its postal logistics process**, which reportedly is in good shape, and could support the transport of payment slips or vouchers to selected post offices where data entry and data communications are available. It would clearly depend on VPSC's business process design, and its capability to distinguish between document flow, data flow, and money (cash) flow—and to design controls and checks for each of them—to be able to cross-check the consistency of each flow.

The **number of non-cash payments rapidly rose**, reaching more than 22 million transactions in 2003. It is assumed that a large number of these transactions were commercial payments and government transfers.

However, with 0.26 cashless transaction-per-capita in 2003, and an additional one million ATM transactions, the **market for payment instruments for the population has been virtually limited to cash**. The pilot projects undertaken by VPSC and several banks show that there is demand for cashless payments instruments, and it appears that VPSC with the wide postal network could play a significant role in developing the market for standardized small-value payment instruments.

Although data on the banks' branch networks were not extensively available, it appears that **there are more post offices than bank branches**. VBARD reportedly has a network of 1,900 outlets with many located in rural areas to give farmers access to finance. The other large banks have much smaller networks, e.g., the Bank for Investment and Development in Vietnam has 160 branches, Incombank 124, Vietcombank 53, Eximbank 9, and Maritime Bank 7. These banks have branches only in cities and the branches are focused on public and corporate sector clients. Some of the foreign banks or joint venture banks have entered the high-end retail market.

Regarding access to (cashless) payment services, VPSC and the postal network seem positioned to fill a large part of the void left by the commercial banks. Given the institutional and technical support rendered to these banks to improve their intra-bank payment systems and operations, it is likely that in the next few years they will be able to serve even more individuals in urban areas. Several of these banks have developed ATM networks, and there might be already 300 ATMs active in Vietnam.

Remittances

The net inflow in Vietnam of private transfers showed a rapid growth from USD 0.7 billion in 1998, to USD 1.5 billion in 2005 forecasted by the International Monetary Fund. Banks, agents of Western Union and Money Gram, private money remitters, and informal channels are the key players in this market. With a flow of less than USD 12 million, or less than 1 percent of the market share, the **postal network has not been a major channel in spite of its dense network**. It mainly processes international postal money orders to and from France, Switzerland, Japan, and Canada.

The postal network could **play a valuable role as the last stop in the intermediary chain between sender and recipient**. The postal networks in the countries from whence the money is sent could also play a more active role. In several of these countries, use of the traditional postal money order has greatly declined. At the same time, postal networks, and their associated postal banks or postal giro services, offer easy access to postal giro accounts from which payments can be made. Connecting Vietnam to the Eurogiro network would enable account holders to send money rapidly and reliably, at very low cost. Although this would not be a complete solution for Vietnam Post or VPSC, it would add to their strategy to grow the volume of remittances.

This could change if product development and marketing were introduced, and if post offices were equipped and trained to provide timely remittance services. This would require upgraded technology at post offices and dedicated marketing toward recipients and Vietnamese diasporas outside the country.

Savings

Through its operations, VPSC has shown a successful entry into the savings market, and **should now find ways to consolidate and to expand in other areas**. With the data currently available, it is difficult to assess the merits of the growth of the savings. First of all the size and break-down of the relevant market of households deposits is not known, and analyzing the growth rate of VPSC deposits within this market cannot be done. It would be important to see if, and in which segments, VPSC's growth rate exceeded the market growth rate. Secondly, it would be useful to evaluate the reasons for success in more depth, e.g., through customer field research; to assess the level of trust in the postal network (or VPSC); and determine the competition with informal and formal alternative savings/investment opportunities.

In view of further stabilization of the market and the dong, VPSC could benefit from an accelerated conversion from informal dollar savings to formal local currency savings. This, however, would require competitive products and conditions.

It would also be **important for VPSC to offer a complete package of financial services rather than only savings or cashless payments instruments**. To effectively provide standard financial services to households, small enterprises, and others, VPSC needs to gradually develop a complete spectrum of services.

Microfinance

Prior to 1990, formal credit institutions provided credit only to state enterprises and production cooperatives. Non-governmental organizations (NGOs) were not allowed to operate in Vietnam, and individual farmers and households could not access credit from formal institutions. The Doi Moi policy, started in 1990, radically altered the nature of the microfinance structure. **By year end of 1997, 47 percent of rural households were served by formal credit institutions, NGOs, and other social organizations;** credit schemes met the needs of 3 percent of households through semi-formal services; and the remaining 50 percent relied upon informal and private credit sources.

The Vietnamese microfinance market is segmented into three main categories: formal, semi-formal, and informal microfinance.

- ***Formal microfinance*** is provided by four key players: Vietnam Bank for Agricultural and Rural Development (VBARD), VBP (now known as the Credit Policy Bank), Peoples' Credit Fund (PCF), and Rural Shareholding Banks (RSHBs), which serve a combined market of 8.3 million rural households. The formal sector provides about 70 percent of microfinance services.

  - VBARD is state-owned and the largest financial institution, providing rural services through a nationwide network. At the end of 2001, it had 60-percent share of the microfinance market, and 35 percent of low income households.[4]

  - VBP focuses on poor households.

  - PCF is a network of cooperative and social financial institutions, which perform an active financial intermediation function.

  - RSHBs resulted from the reorganization of rural credit cooperatives and have a 10 percent government shareholding, but a minor share of the market.

- ***Semiformal microfinance*** is provided by three main groups including national programs, financial services from social organizations, and international NGO microfinance schemes.
- ***Informal microfinance*** providers include private moneylenders, relatives, and traditional rural credit associations, similar to rotating and savings co-operatives, or ROSCAs.

Microfinance is seen as an important strategy to reduce poverty and promote economic growth in Vietnam. Not surprisingly, the role of the state in the expansion of financial services has played an important role in shaping the environment and context of service delivery. **The legacy of state domination of the microfinance sector has impeded its development as a commercially viable industry.** Policies that have impacted sustainability include the socially-motivated use of client loan rates, which were not commercially sustainable (including policies requiring a small spread between the savings and the lending interest rates); dependence on subsidized or quasi-commercial funding; and a lack of emphasis on savings mobilization.

Informal sector lending is hugely important in rural Vietnam. Informal lending comprises group lending, the co-operative People's Credit Fund, credit schemes from joint stock banks and foreign NGOs, as well as some government-subsidized lending schemes targeted for specific purposes. Interest rates on loans in the informal sector were typically two or three times that of the government bank. The government seemed to have been meeting much of the demand from credit-worthy households, even if doing so with low rate loans, but there is a persistent level of high-interest informal sector lending in Vietnam.

A significant portion of the households in Vietnam get little or nothing from the formal financial sector. A combination of factors have perpetuated the continuing use of the informal sector by poorer segments of

[4] M. H Quach, " Toward a Sustainable Microfinance in Vietnam" (Birmingham, UK: University of Birmingham, 2003).

Vietnam including lack of collateral, remote locations, loan restrictions on use of proceeds, and small loan sizes, among others.

Although market distortions have resulted from the prevailing market structure and government policies, the government policies have had a substantial impact because of the large volume of funds that have been directed into rural microfinance since the mid-1990s. The role of the VBARD and VBP in financing a majority of the creditworthy rural households and crowding out some of the informal moneylenders has to be viewed as a positive achievement.

There is **no clear regulatory framework for microfinance institutions** (MFIs), although Vietnam is working on a possible framework with assistance from the Asian Development Bank. The draft decree recommended a two-tiered regulation system for MFI programs with and without savings mobilization. Co-operatives serving mainly rural areas would fall under separate legislation. There have also been a number of notable policy and legal reforms since 1996 that have had an impact on the microfinance environment, including the trend towards positive real interest rates over the last three years, greater flexibility for commercial banks in deciding loan guarantee requirements, the switch to a base-rate method of setting interest rates, and others.

Defining the size of the Vietnam microfinance sector can be distorted by the dominance of large government bank sector and activities. Total NGO rural microfinance lending is estimated to amount to 7 percent of formal government schemes or about 4 percent of total rural microfinance lending[5] (USD 377 million compared to USD 1.9 billion for the government bank programs). Ten large NGO schemes account for 90 percent of NGO activities. Basic data on the industry taken from a 1999 PlaNet Finance[6] publication indicated that there were some 6.1 million clients, with a loan portfolio outstanding of USD 1.76 million, and an average loan size of USD 150. There were estimated 2700 points of service or outlets, based on the 1999.

Savings mobilization has lagged in Vietnam, and fewer than half of the microfinance schemes or organizations in Vietnam reported collecting savings from households. Various studies cite the traditional policies of setting low lending interest rates as the primary disincentive to savings mobilization. NGOs in general have not shown great interest in providing savings services to the poor in Vietnam. Other government policies have contributed to the lag in savings mobilization, including the minimum deposit levels accepted by BVARD branches and by other commercial banks. VBARD deposits are overwhelmingly urban rather than rural. A lack of well-designed savings instruments for mobilizing public savings contributes to the problem.

In this context, the postal network and VPSC could fill a gap in the market and contribute to a further shift from the informal to the formal sector. An essential condition for undertaking such a mission in the microfinance sector is the design and implementation of transparent and intrinsically strong institutional framework for VPSC.

3—Options for Development

Five years after its introduction, the Vietnamese Postal Savings Corporation can look back on an impressive record of successes. With its 920 post offices (of 3,000), VPSC operates the second-largest financial service network in the country. It developed as a channel for mobilizing small household deposits, nearly 400,000 individuals keep accounts with the VPSC, and it has mobilized about 1 percent (VND 4 trillion) of the nation's savings. It has also **pioneered modern cashless payment services, and provides payroll and card-based services. The next step in its development is the integration of the postal payment services into its operations.** However, after an initially fast growth track, VPSC currently faces increasing stagnation in its growth, mainly due to government limitations on its institutional and regulatory framework. Changes are

5 Adam McCarthy, "Microfinance in Vietnam: A Survey of Schemes and Issues," Final report (April 2001) from workshop sponsored by U.K. Department for International Development and the State Bank of Vietnam in Hanoi, on January 31, 2001.

6 CEP Fund, "Vietnam," Planet Rating (Paris: PlaNet Finance, 2003).

required to enable sustainable growth of VPSC and including the post offices in its provision of low-threshold access to basic financial services.

VPSC has some significant limitations facing it:

- VPSC is not a licensed bank, but operates on the basis of a special decree from the prime minister. Essentially, it can take deposits only in certain post offices that meet certain requirements. VPSC can not develop a complete package of financial services for its clients.
- The deposit-to-asset conversion is not at the discretion of the management of VPSC. Pursuant to instructions by the minister of finance, the largest part of its assets is redirected to NDAF, which remunerates the funds at below-market rates as developmental loans.
- VPSC has privileged access to the post offices, but cost allocation and compensation, its investments in the post offices, responsibilities, and reporting procedures and systems do not seem to have been agreed upon in a transparent fashion, and may include mutual cross-subsidizing. On the other hand, VPSC’s rapid growth has generated substantial additional revenue for the postal system, contributing to covering its fixed costs.
- VPSC is not connected to the inter-bank payment system, although the postal network processes a considerable volume of semi-cashless payments, and could play a significant role in the transition from the current cash society to a cashless payment system in the next 10–20 years. To connect, VPSC needs to be a licensed bank.
- VPSC has no access to funding and finance sources to upgrade the postal network and to efficiently involve a larger part of the postal network. VPSC, within the VNPT structure, also has limited access to skilled and trained banking staff.
- VPSC's profitability is unlikely to be sustainable, as a result of below-market rates from NDAF, and the required cost and investment levels to operate through the post offices.

With this set of limitations, the future development of VPSC is likely to meet obstacles that will slow down the pace of its development. Given the vibrant development of the Vietnamese financial sector, it seems imperative that consideration be given to transforming the regulatory and institutional framework of VPSC. The transformation should serve the following objectives:

- Continue and expand VPSC's services under a banking license and insist on compliance with the regulations of the State Bank of Vietnam; operate VPSC service on a level-playing field with other commercial banks in Vietnam
- Make VPSC's payment operation join the inter-bank payment system
- Diversify VPSC's asset portfolio and redirect funding to VBARD, to other banks, financial institutions, and eventually credit clients
- Insist that the relationship of VPSC and the post offices be transparent in terms of responsibility, liability, reporting procedures and systems, technology, equipment, training, marketing and advertisement, and the related costs and financing of capital expenditure.

These are fundamental and structural issues. It would useful to undertake a more in-depth analysis of these issues before restructuring the VPSC. In addition, it would be helpful if the reform of VNPT and the postal (sector) reform were prepared and clarified in parallel with the transformation of VPSC.

Issues that need clarification in the process of developing VPSC are:

- the separation of VNPT, intended privatization, and its relation to the 61 PTT enterprises and their (postal) networks;
- the commercial viability of Vietnam Postal Service; the outline of its economic turnaround, and the role of postal financial service delivery in that context, as well as the envisaged relationship between Vietnam Post and the 61 PTT enterprises; and
- the actual information and communications technology and e-programs that will be installed and implemented, and the role of the 61 PTT enterprises.

A key issue here is whether the more than 3,000 post offices within the 61 PTT enterprises will eventually fall under the management of the unprofitable Vietnam Postal Service—with the consequent threat of closing a large number of post offices.

Or—alternatively—what if the 61 PTTs become a separate company responsible for managing the PTT retail network; are given the management, mission, and discretion to develop new retail communication and e-businesses; and given service level agreements with its historical users (namely Telecom, Vietnam Post, the press publishers, VPSC, and the government); along with reforming the post offices and transferring the ownership and management of small and medium-size post offices to the private sector under agency or franchise agreements?

The issues above appear to lead to the conclusion that a viable development of VPSC requires an updated and in-depth diagnosis of the entity, its market position, and its legal and institutional environment. A key question will be whether VPSC can develop into an institution that qualifies as a bank or whether it would have to do so through strategic alliances or partnership. Given the breadth and depth of issues that VPSC has to deal with, it makes sense to initiate a step-by-step approach to prepare and develop VPSC and to prepare the key stakeholders to make the required basic decisions for the future positioning and development of VPSC.

One option is to arrange a strategic technical or management partnership in which VPSC would be twinned with a savings bank or postal bank, and accelerate the process through management support, training, and advisory assistance. Such a program should lead to the eventual restructuring of VPSC as qualified or licensed credit institution or to a long-term strategic alliance with a licensed credit institution.