## 3. Financial Support for SMEs: Credit Guarantee Schemes and SME Development Fund[53]

1. **Despite the considerable size of the SME sector in Vietnam's economy, access to finance is a major hurdle for many SMEs.** According to a 2022 government report, the country has about 800,000 SMEs, which made up 98 percent of all registered businesses.[54] These companies employed around 70 percent of the workforce and accounted for about half of the country's GDP. However, many SMEs face difficulties in securing funding. Roughly 30 percent have access to bank credit, and about a quarter consider financial access the main obstacle in their business operations.[55]

2. **Credit guarantee schemes (CGSs) and the SME Development Fund (SMEDF) are two main avenues of financial support available to SMEs.** Recognizing the challenges faced by SMEs in obtaining credit, the government started issuing legal frameworks for the creation of CGSs in 2001 and the SMEDF in 2013. Alongside commercial banks' own loan products that are tailored to SMEs, the CGSs and the SMEDF are two main channels through which SMEs can get financing in Vietnam. The current selected issue discusses these two channels.

### Credit Guarantee Schemes

3. **There are two main types of CGSs, one of which is in the form of local credit guarantee funds (CGFs).** These funds were established by provincial People's Committees, guided by a series of decrees dating back to 2001. The charter capital mostly came from provincial budgets – with the rest contributed by local financial institutions – with the goal of providing credit guarantee to businesses that faced difficulties in accessing financial resources. CGFs function as non-profit financial organizations and are managed by provincial People's Committees. At present, the combined charter capital of all local CGFs is around VND1.4 trillion, the lion's share of which is publicly owned.[56]

4. **The other type of CGS is operated through Vietnam Development Bank (VDB).** Recognizing the need to further enhance SMEs' financial access, the government issued a number of regulations during 2009-2011, according to which VDB – wholly owned by the government and mandated to fund business activities in line with Vietnam's development – was assigned to serve as the country's other major provider of credit guarantee. As the institution was already in the lending business, particularly for enterprises under government support, VDB was deemed a suitable addition to the CGS landscape. At present, the bank has charter capital of VND30 trillion.

5. **According to government regulations on credit guarantee, the borrower's own equity needs to account for at least 15-20 percent of the cost of the business project for which the loan is given.** In the case of local CGFs, the regulations are as follows: the borrower's own equity has to be at least 20 percent of the project cost; the total guarantee extended to a single enterprise and its related parties cannot exceed 20 percent of the local CGF's charter capital; and the total guarantee extended by a local CGF cannot exceed three times its charter capital. As for credit guarantee provided by VDB, the regulations are as

[53] Prepared by Jade Vichyanond, Economist.
[54] Ministry of Information and Communication. Viet Nam News (2023). *SMEs Development Fund Plans Further Reduced Interest Rates.* https://vietnamnews.vn/economy/1582453/smes-development-fund-plans-further-reduced-interest-rates.html
[55] OECD (2021). *SME and Entrepreneurship Policy in Viet Nam.* OECD Studies on SMEs and Entrepreneurship.
[56] Based on AMRO's discussions with several institutions. This amount has remained roughly stable since 2017, when there were 27 local CGFs, which had combined charter capital of VND1.5 trillion, of which 90 percent was from provincial budgets and the remainder was from contributions of the private sector, primarily local credit institutions. Le and Anh (2019). *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.

follows: the borrower's equity has to be at least 15 percent of the project cost; the total guarantee extended to a single enterprise cannot exceed 5 percent of VDB's charter capital; and the total guarantee extended by VDB cannot exceed five times its charter capital.

6. **While local CGFs require collateral to grant credit guarantee, VDB has no explicit collateral requirement.** Local CGFs stipulate a collateral requirement of 15 percent of the guaranteed amount, whereas VDB does not have an explicit collateral requirement. For both types of CGSs, the amount of guarantee depends on the specific needs of the given loan and can cover up to the entire value of the loan. As for guarantee fees, local CGFs charge 0.5-1 percent of the guaranteed amount per annum, while the fee at VDB is 0.5 percent.

7. **The total amount of guarantee provided by both types of CGSs since their inception has been relatively limited.** In the period of 2002-2016, the cumulative amount of credit guarantee granted by local CGFs was only USD179 million. As the guarantee was provided for US$224 million of loans, the average guarantee was around 80 percent of the loan value.[57] Meanwhile, VDB only issued credit guarantee during 2009-2011, with a total guaranteed amount of USD571 million.[58] From 2017 onwards, VDB has officially ended its credit guarantee activities, as directed by the government.[59]

8. **One of the main challenges in the development of the CGS infrastructure in Vietnam is human resource capacity, which often leads to unwillingness to extend credit guarantee.** As local CGFs are managed by provincial People's Committees, loan appraisal is undertaken by staff members of the committees who for the most part lack such experience and hence are often unwilling to provide credit guarantee. The hesitation is largely due to fear of criminal prosecution (i.e. in case of loan default and subsequent guarantee activation), which has intensified over the past few years in light of the anti-corruption campaign within the government.

9. **Another challenge lies in the complicated procedures for guarantee applications and guarantee activation.** First, a substantial amount of paperwork is required in applying for credit guarantee, which – compounded by the lack of transparent financial accounting on the part of SMEs – makes the application process cumbersome. Moreover, for local CGFs, guarantee activation involves the participation of numerous agencies (i.e. the provincial People's Committee, the local Department of Finance, among others), which sometimes complicates the process of collateral disposal, thereby discouraging commercial banks from accepting credit guarantee.[60]

10. **Collateral requirement has also been a key factor in limiting the growth of local CGFs.** For example, the Ho Chi Minh City CGF – one of the most active CGFs in Vietnam – and the Bac Ninh CGF were growing healthily up until 2013, when a new policy on collateral requirement was announced.[61] (Prior to this, there was no explicit collateral requirement.) After the policy came into effect in 2014, the value of newly guaranteed loans decreased significantly.

11. **Moreover, the limited size of existing CGFs may hamper their ability to significantly enhance the overall SME sector's access to funding.** Based on regulations

[57] Le and Anh. 2019. *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.
[58] Information obtained from VDB upon AMRO's data request, using the average exchange rate of 18,729 VND/USD during 2009-2011.
[59] The direction was outlined in the government office's document No. 8273/VPCP-KTTH, which gave no rationale for ceasing VDB's credit guarantee activities.
[60] Le and Anh. 2019. *Challenges in Implementing the Credit Guarantee Scheme for Small and Medium-Sized Enterprises: The Case of Viet Nam.* ADBI Working Paper Series.
[61] The amended Decree 115/2004/QD-TTg, in accordance with Decision 58/2013/QD-TTg.

governing leverage ratios, local CGFs have the potential to provide up to only VND4.2 trillion of credit guarantee, a low level considering the role that SMEs have in the economy and their financing needs.[62]

12. **Looking ahead, greater participation of the private sector, particularly commercial banks, in local CGFs may lead to greater provision of credit guarantee to SMEs.** To the extent that bank ownership increases, banks will be incentivized to become more involved in the administration of credit guarantee, which will likely enhance local CGFs' operational performance – due to greater experience in loan appraisal and management, as experience from various countries has shown – and result in higher approval rates for credit guarantee.[63]

### SME Development Fund

13. **The SMEDF is a non-profit fund established in 2013 by the government to support the SME sector, primarily through lending at preferential rates.**[64] The development fund, backed by charter capital of VND2 trillion from the state budget and managed by the Ministry of Planning and Investment, started operations in 2016, channeling funds to SMEs through five commercial banks. In 2019, a decision was made for the fund to start lending directly to SMEs.

14. **Loans are provided at preferential rates and cannot exceed 80 percent of the cost of the business project.** At present, the rates are 1.2 percent for short-term loans and 4.4 percent for medium and long-term loans.[65] According to the regulations, the loan value cannot exceed 80 percent of the project cost, with the enterprise's own equity having to constitute at least 20 percent. The maximum maturity of SMEDF loans is seven years, and the maximum grace period for repayment is two years.

15. **As is the case with CGFs, the SMEDF's growth has been limited, especially considering the demand for SME financing in Vietnam.** As of August 2023, the SMEDF has disbursed less than VND600 billion since its inception.[66] In terms of reach, fewer than 40 SMEs have been beneficiaries of the fund's lending program.

16. **Strict loan criteria are a major hindrance for usage of the SMEDF.**[67] Since 2019, the scope of SMEDF support has been narrowed to only SMEs that are considered innovative startups or part of business clusters or value chains, rendering vast numbers of SMEs such as co-operatives and household businesses ineligible for SMEDF loans. Moreover, SMEDF funding is available only for asset-backed projects, not for other purposes such as working capital.

17. **Recalibration of lending criteria may be needed with a view to increasing the usage of SMEDF loans.** The government's periodic adjustment of preferential interest rates, such as the recent rate reduction in October 2023 in response to the subdued economic environment, is commendable. Going forward, recalibration of loan criteria, such as widening the scope of business activities and sectors eligible for funding, may help increase awareness of SMEDF among SMEs and lead to greater utilization of its lending facility.

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[62] VDB's maximum credit guarantee is VND150 trillion, but its credit guarantee function has been discontinued (see paragraph 7).
[63] Gozzi and Schmukler. 2016. *Public Credit Guarantees and Access to Finance.* Warwick Economics Research Paper Series.
[64] The SMEDF's remit also includes capacity building through training and consultancy.
[65] These rates are adjusted occasionally by the government depending on macroeconomic conditions.
[66] Viet Nam News. 2023. *SMEs Development Fund Plans Further Reduced Interest Rates.* https://vietnamnews.vn/economy/1582453/smes-development-fund-plans-further-reduced-interest-rates.html
[67] OECD. 2021. *SME and Entrepreneurship Policy in Viet Nam.* OECD Studies on SMEs and Entrepreneurship.