

LAOS Country Profile

In This Document:

- Needs for Microfinance
- Microfinance Sector Development
- Regulations and Government Initiatives
- Practices
- Innovations
- Providers
- Funding and Supporting Organisations

Lao PDR is a landlocked country, one of the poorest countries in Asia and among the least developed countries of the planet. 90% of its 5.5 million inhabitants work in rural areas, mostly in subsistence agriculture. Since the late eighties, Lao PDR has introduced market-based principles to an economy previously organized under a centrally planned socialist model.

Needs for Microfinance

The economy of Lao PDR is still largely supported by agriculture-based activities, with 80% of its workforce involved in agriculture, which generates 51% of the GDP (Fukui and Llanto, 2003). Approximately 30% of the population lives under the poverty line, with 90% of the poor living in rural areas. Accessing new economic opportunities in rural areas could have a significant impact on poverty alleviation.

However, the formal banking sector is still underdeveloped, with three public banks, three joint-venture banks and eight foreign banks. The three public banks serve 70% of the financial sector, and are going through a restructuring process, in order to reduce non-performing loans and to modernize. The formal banking system is mostly concentrated in Vientiane and other cities, and have limited outreach in rural areas, with only 11% of the rural population having access to formal financial institutions, and only 1% making saving deposits (Fukui and Llanto, 2003). An exception is the Agricultural Promotion Bank, which has a rural branch network throughout all provinces.

It is estimated that 75% of the population do not have access to formal or semi-formal financial services. According to a report from the Bank of Lao (2002), the potential microfinance market is 268,000 borrowers and 560,000 depositors. The same report shows that only 25% of this market is currently served by microfinance providers (APB and moneylenders being the main financiers)

Microfinance sector development

The microfinance industry is still at an early stage of development in Lao PDR. With the first initiatives launched in 1997, the microfinance sector in Lao PDR is still young and constrained by public interventions, lack of regulatory framework and the existence of short-term, subsidized development projects. There is also a general lack of understanding of microfinance principles.

The government of Lao PDR started to support microfinance with several development projects being implemented through bilateral cooperation, and the involvement of the Agricultural Promotion Bank. Over the years, international donors and NGOs have initiated various village-based revolving funds, usually as a component of a larger project, often in-

kind, and typically through Lao Women's Union. Most projects are credit-oriented, supply-led, and do not consider long-term sustainability as a major objective. Despite the success in including women and minorities as microfinance clients, and the widespread use of community-based delivery mechanisms, the development of the microfinance sector in Lao PDR still face major challenges.

Vast regions of Lao PDR have low population density, low-skilled rural populations, poor infrastructure and limited cash economy. This results in difficult and costly access to the economic active poor, the typical microfinance client, who has limited opportunities to develop its microenterprise, and has to rely on subsistence economy.

There is also a lack of awareness of international best practices, and only a few local institutions and international NGOs' projects have the potential to be transformed into MFIs, provided that legislation for microfinance is enacted. There is generally a lack of understanding and practice of sustainable interest rates, methodologies and controls and systems.

Microfinance is badly affected by subsidized government programs, distorting the market with low repayment rates and subsidized interest rates.

There is also a lack of coordination among microfinance players, as no forum or network exists in Laos. This industry body could promote sharing of experiences, best practices, standards and self-regulation.

The only valuable experiences in microfinance, which also focus on long-term institutional development, have been the UNDP/UNCDF Microfinance Project (1997-2002), a private credit union movement (FC/CCSP) and the Phongsaly District Development Project (PDDP) supported by AFD. However, each project had limited outreach, with approximately 2,000 to 3,000 clients served in each case.

Regulations and government initiatives

The lack of regulatory framework for microfinance does not allow microfinance initiatives and projects to transform into strong institutions free from government interference, to set market-based interest rates, and to be able to enforce loan contracts. Current regulations cover only credit cooperatives, without including issues such as governance, financial systems and auditing, risk and liquidity management.

In 2002, the government set up an inter-ministerial committee, chaired by the central bank, the "Rural and Micro Finance Committee" (RMFC) to prepare a national policy and action plan to develop a conducive environment to the growth of the microfinance sector. The committee was established on the foundation of a consultative committee inherited from the UNCDF microfinance project. The committee is a consultative body, with limited decision-making capabilities.

The national policy statement, drafted by the RMFC, with support from the World Bank, ADB and the NERI-Concern Worldwide microfinance project, was recently approved by the office of the Prime Minister. The general policy statement proclaims "Sustainable rural and micro finance can be effective tools for poverty reduction, which can help Lao PDR to emerge from Least Developed Country status by 2020. The government of Lao PDR's reform program in rural and micro finance will enable the sector to expand significantly, with diversity, security and future sustainability."

The action plan to implement the Rural and Microfinance Sector (RMF) reform promulgated in the policy statement consist of three main areas:

1. Build common understanding and consensus on government's policy and vision of the RMF reform.

2. Strengthen existing RMF initiatives and institutions to ensure their sustainability and their contribution to poverty alleviation (currently the majority of RMF initiatives are unsustainable)
3. Develop enabling legal and policy environment for the establishment and development of diverse MFIs. (currently, the majority of RMF initiatives are operated by public entities)

However, this policy is still not widely shared among government programs and agencies and mass organisations, which are still using subsidized lending, negatively impacting the development of alternative microfinance organisations.

In addition, the ADB financing package includes support to the Bank of Lao in the creation of an enabling policy framework. Under the draft microfinance law, large MFIs would need to be licensed, while smaller MFIs and CBOs would only need to be registered.

The government has promoted the development of a national microfinance resource center, providing capacity building and research support to the microfinance sector, housed in NERI and supported by Concern Worldwide.

The development of the microfinance sector has been supported recently by a group of donors "first initiative" funding US\$4 million worth of technical assistance, which entails the setting up of a microfinance unit in the Bank of Lao PDR, training and capacity building in APB, external technical assistance to government entities, and seed capital for microfinance pilot projects

Practices

The common practice used in Lao PDR is mainly a combination of community-based models (self-help groups, village banking, cooperative and credit unions) including revolving loan funds used to disburse loans to solidarity groups members. It is estimated that the largest mass organisation, the Lao Women's Union (LWU) has initiated revolving loan funds in more than 1,600 villages. Traditional Rotating Savings and Credit Associations (RoSCAs) also operate in Lao PDR. In fact, community-based models seem to be the most suitable methodology for Laos, given the low density of population and the difficult access to remote areas. In more densely populated regions, more formal cooperatives seem to obtain good results.

The community-based schemes seem also more adequate for rural populations with low education level, as these schemes include non-financial assistance, such as management training, capacity-building exercises, and aims at fostering the empowerment of local communities.

As in many parts of the world, savings seem to be the forgotten half of microfinance in Lao PDR. Among international development projects, only two put emphasis on savings mobilization. The Women in Development Project (implemented by LWU/FIAM) in Vientiane municipality and the community based Rural Development Project for Reservation of Watersheds in Oudomxay Province (implemented by GAA). These projects established village savings and credit schemes by mobilizing local savings.

Innovations

The development project OCISP started by a study tour of other microfinance components of development projects in Lao PDR, in order to learn from them.

The Asian Development Bank has financed a pilot project supporting three market-oriented, member-owned savings and credit unions to demonstrate their viability and benefits.

Moreover, the project implemented by Save the Children Australia and Lao Women's Union lent funds to local communities to set up village savings and credit schemes, instead of

providing only grants. The loans allowed the project to set up 7 more village savings and credit schemes.

The Women in Development Program focused only on community-managed savings groups.

Providers

Microfinance providers belong to the formal, semi-formal and informal financial sectors. In the formal sector, the state-owned Agricultural Development Bank (APB) is the major institution involved in microfinance. The semi-formal sector is dominated by credit unions and cooperatives, and development projects funded by bilateral and multilateral aid, and implemented by government programs, local organisations or international NGOs. The informal sector regroups RoSCAs but mostly money lenders, with the largest outreach.

Outreach

In terms of outreach, government programs and departments and mass organisations provide 80% of the microfinance services, while banks provide 15% and semi-formal community-based organisations serves 1% of the population. The Lao Women's Union is the largest provider in terms of number of beneficiaries, with almost 200,000 beneficiaries (Darachanthara, 2004)

<i>Service Provider</i>	<i>Targeting</i>	<i>Savings</i>	<i>Interest rate</i>	<i>Methodology</i>	<i>Sustainability</i>
FORMAL SECTOR					
State-owned Commercial Banks Lao Dev Bank BCEL	Mainly urban and semi urban communities involved in micro and small enterprise activities	Compulsory savings required to access loan	Interest rate fixed by government policy	Accessibility difficult due to paperwork and formalities	Under restructuring
APB	Semi urban and rural farmers	Compulsory Saving required to access loan	Subsidized interest rate, will change in future.	Solidarity Groups. Accessibility is difficult due to paperwork and formalities	Heavy losses. Large number and volume of non-performing loans. Restructuring program.
Formal Credit Cooperatives	Mostly micro and small urban entrepreneurs. Some from rural areas.	Private shareholders and cooperative members. Voluntary and compulsory savings	Trends towards using market-based interest rates	Cooperative legal status, limited company	Aim at reaching operational sustainability
SEMI-FORMAL SECTOR					
	Rural poor	Shares of	Cover	Business	APB with

Credit Union	communities	equity capital. Aims at providing positive return on savings	operational costs and consider growth of capital	orientation, community membership.	technical assistance from ADB launched pilot in 4 provinces
INGO Projects	Mostly poorest and remotest area (such as ethnic minorities)	Compulsory and voluntary savings (cash or in kind)	Often subsidized interest rate determined by the management committee	Self-Help group (CBOs, Village banking) with focus on institutional development	Usually high subsidies involved (but exceptions exist)
Bilateral Projects	Urban and rural poor	Credit orientation. Savings are not often required	Often subsidized interest rate determined by the management committee	Several methodologies followed	Difficult to sustain after project hand over.
INFORMAL SECTOR					
Savings & Credit Groups	Poor and poorest people	Encouraged voluntary savings in addition to compulsory savings	Often subsidized interest rates determined by the management committee	Self-Help group (CBOs, Village banking)	Difficult to sustain after project hand over.
Other (RoSCAs, money lenders, huayi, traders and moneylenders)	No specific target people	No savings required, good understanding and trust are key factors	High	Informal operations	Very quick and prompt services. Interest rate covers high risk.

Adapted from Money Matters and More, SNV Netherlands, 2004

Formal sector

The only formal financial provider in rural areas is the state-owned Agriculture Promotion Bank (APB), which has over the years accumulated losses, non-performing loans, and has been restricted by government policies, such as the use of subsidized interest rates. APB is now providing access to microfinance to 40,000 households (or 5% of the population). Since the mid-nineties the government, at national and local levels, has participated to microfinance projects, using mass organisations as microfinance conduits, such as the Lao Women's Union. (Fukui and Llanto, 2003)

Semi-formal sector

International NGOs and aid organisations usually implement short-term, project-based microfinance activities, with no real focus on long-term sustainability, creating bad precedents for the other microfinance players in Lao PDR. Major exceptions to this trend are worth noticing:

- Microfinance and Sustainable Livelihood in LAO PDR Project (1997-2002).

This major microfinance pilot project was supported by UNDP-UNCDF, and managed by the Ministry of Finance. At the national level, it provided capacity building, support to the development of a regulatory framework and advisory services in microfinance to public entities. At provincial level the project supported the development of MFIs called 'Accredited Agents' (AA), which were local branches of APB and Lao Women's Union, and the INGO Save the Children. It also supported the development of local cooperatives, and used PACT as technical assistance provider. The project used solidarity groups for credit operations and compulsory savings. In later years of implementation, the overarching goal of the project was "to help reduce poverty" through the development of a "nation-wide MFI responsive to the financial needs of low-income groups", which would transform the AA into full branches of a newly created MFI. The project ended in 2002, failing to reach the institutionalisation stage as the government of Lao and UNCDF-UNDP disagreed on the modalities. Some of the project groups are still active in microfinance. In addition, some former staff members have initiated their own microfinance organisation, charging market interest rates to their clients.

- Rural Development Project in Bokeo Province

The project, implemented by GTZ, started in 1997 with the establishment of "Village Contribution Funds" in targeted villages. The project provided an in-kind contribution to villagers who then repaid part of the amount in cash into Village Development Funds. Each Fund was managed by a village committee, and was used to provide credit. A few years later the funds were transformed into Village Revolving Funds (VRF), providing credit only, and replenished by contributions from villagers. As of July 2003, there were 3,200 families participating in 46 village VRFs.

- Phongsaly District Rural Development Project

Also established in 1997, the project introduced a self-managed village bank approach. It is implemented by the French NGO, Comité de Cooperation avec le Laos (CCL) In the initial phase, the project set up 5 pilot village credit schemes, called Village Development Funds (VDF), which are now extended to 54 village credit schemes. The project constitutes the VDF capital through annual members' contributions. Loans are guaranteed by solidarity group of five to ten families. As of 2004, there were 2,154 families members of 54 VDFs. Problems with repayment were reported.

- Women in Development Program in Vientiane Municipality

The main objective of the program is to strengthen capacity of women to set up community-managed savings groups. The program started with 15 savings groups in 1997, through a partnership between Lao Women's Union, FIAM (a Thai NGO) and the Foundation for Community Development (FCD). Savings groups were not supported by initial project capital contribution, which focused on technical support only. Members could access loans from the savings groups after savings during three months.

- Community-based Rural Development to Reserve Watershed Project in Oudomxay Province

Implemented by the NGO German Agro Action (GAA), the project started to set up savings funds in 6 villages in 2001, from members' savings and project contributions. There are now 16 Savings Funds in 15 villages, managed by a local village committee. Members can obtain loans from the funds, and a dividend at the end of the year.

- Development Project in Bolikhamxay Province

Implemented jointly by Save the Children Australia and the Lao Women Union, the project began by setting up four pilot village savings and credit schemes (VSCS) in 2001. The project aimed to strengthen local capacity of women, especially of providing access to credit in support of income generating activities. The project contributions were made through loans to VSCS. The loans repaid two years later were used to establish 7 additional funds. The funds are generated by savings and initial profits made on the project contribution revolving fund, and are used to disburse credits. The loans are guaranteed through a solidarity group mechanism, which consists of five to ten families including one or two poor families.

- Lao-Luxembourg Integrated Rural Development Project in Bolikhamxay Province
The project started its microfinance component at the end of 2003. It set up two pilot "Village Cash Credit Schemes" (VCCS), through annual project contribution, 9 times what members have made in voluntary contributions, over a three year period. Loans from the VCCS are guaranteed by a solidarity group (8-10 families) methodology.
- The Community-Managed Livelihood Improvement Project funded by a US\$1 million from the Japan Fund for Poverty Reduction, managed by the ADB, includes village-based revolving funds. The funds provide members with small initial loans of 500,000 kip (\$50), increasing in size over time.
- Oudomxay Community Initiatives Support Project (OCISP) is funded through a loan from IFAD and financial support from Lux Development and WFP. The project is an eight year long project, starting in 2002, covering 150 villages, reaching 10,000 households, with five components: community development, agricultural development, rural finance services, rural infrastructure, and institutional capacity building.

Started in 2004, the rural finance services component of the project aims to build and use community-based organisations, village-based savings and credit schemes, as conduits for microfinance. It uses a savings-based model, where members are required to save during nine months, before receiving a matching fund of 9 to 1 in proportion to the savings accumulated. In the current pilot phase, the project works with 14 groups of 30 members, with the objective of reaching 60 groups overall. Progressively the groups are given more autonomy in taking decisions, and after one to two years become fully independent. At the end of the project, plans are to set up an apex institution that will respond to the financial and technical needs of CBOs, managed by the government, a public or a private company.

The project started with a study tour of other development projects in Lao PDR. The major findings were that projects were implemented too quickly, without a real understanding of the needs of local government authorities and beneficiaries.

- SNV Laos provides support the capacity building of microfinance providers, such as Lao Women's Union, APB and the Credit Unions, and research methodologies and lessons learned in microfinance.

The development of a modern cooperative movement in Laos is still in its early stages, as there is no formal legal status, and only exist young and relatively small organisations. The main cooperatives are the Fonds Cooperatif and its network of Credit Cooperative for Promotion of Small Producers (CCSP) and the Sihom Credit Union.

Informal sector

There are also thousands of traditional, autonomous savings and credit associations, using revolving loan funds set up at village level. Most village revolving loan funds were established by international projects and NGOs, in partnership with the Lao Women's Union,

using its experience and extensive network. Even if these schemes have been active in community development, they are not generally seen as effective financial intermediaries, charging below-inflation interest rates, and lacking management capacity to reach sustainability.

The other main forms of informal finance are in-kind banks (rice and buffalo), RoSCAs (or Houay), loans from friends and family, credit from suppliers (to a limited extent), and moneylenders (mostly in urban areas).

Funding and Supporting Organisations

Through ADB financing, a microfinance fund will be set up to support the creation and development of MFIs in Lao PDR.

The APB and the Bank of Lao PDR benefits from a US\$10 million loan and a US\$2 million technical assistance grant from the Asian Development Bank. The goal is to develop a sustainable, market-oriented rural financial system to contribute to poverty reduction. It entailed support to rural finance policy development, ABP's transformation into a commercial-oriented model, such as BRI in Indonesia. A major portion of the loan will be used for the recapitalisation of APB, a smaller portion for the modernization of MIS and the IT system. In addition, the funding will be used to pilot-test three commercial-based savings and credit unions, with WOCCU involvement.

Micro Finance Capacity Building and Research Project (MCBR)

The MCBR is a four-year project (2003-2007), implemented by the National Economic Research Institute (NERI) / Committee for Planning and Cooperation (CPC) with support from Concern Worldwide. The project aims to address several major barriers impeding the growth of the micro finance sector. The overall goal of the project is to improve the livelihood security of poor people in Laos by the promotion of diverse micro finance services through sustainable mechanisms. Under this project, NERI aims to develop a national micro finance unit, action research projects with microfinance practitioners, to establish a microfinance resource centre and links with national, regional and international networks.

In addition, a group of private individuals has recently created the "Microfinance Training Center", a component of Mekoxab Business Development Consulting Company, and will start providing microfinance training in 2005.

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