Ministry of Agriculture and Forestry
Department of Rural Development

Lao Microfinance Association

Situation of Over-Indebtedness in the microfinance sector of Lao PDR

November 2021

Supported by:

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Acronyms

ADA	Appui au Développement Autonome
AFP	Access to Finance for the Poor. GIZ Project supporting VFs in partnership with BoL
BoL	Bank of Lao PDR
CIB	Credit Information Bureau
DTMFI	Deposit-Taking Microfinance Institution
DRDC	Department of Rural Development and Cooperatives
FIR	Financial Inclusion Roadmap 2018–2025
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GoL	Government of Lao PDR
LMFA	Lao Microfinance Association
LSB	Lao Statistics Bureau
LuxDev	Luxembourg Development Cooperation Agency
LWU	Lao Women's Union
MAF	Ministry of Agriculture and Forestry
MF	Microfinance
MFI	Microfinance Institutions, regrouping DTMFIs, NDTMFIs, SCUs
MIS	Management Information System
MSME	Micro- Small- and Medium-Enterprise
NDTMFI	Non-Deposit-Taking Microfinance Institution
NSO	Network Support Organization: apex organization for VF implemented by GIZ
OID	**Over-Indebtedness /Over-Indebted**
PAR	Portfolio-at-Risk: percentage to the total value of the loan portfolio of the aggregated value of loans with repayments of principal or interest overdue, even partly, for more than 30 days
SCU	Savings & Credit Union
TFRF	Task Force on Rural Finance
VB	Village Bank (referring to GIZ-AFP approach using a tiered network with 7 Network Support Organizations)
VCS	Village Credit Schemes (referring to LuxDev LAO/030 programme and GoL 500 million fund program)
VF	Village Fund: umbrella regrouping VBs and VCS
WB	World Bank

Acknowledgements

This survey on the Situation of Over-Indebtedness in the microfinance sector of Lao PDR, the first exercise of its kind, was commissioned by the Lao Microfinance Association (LMFA) under the guidance of the Financial Institution Supervision Department, Bank of Laos, and the Department of Rural Development and Cooperatives (DRDC)[1] of the Ministry of Agriculture & Forestry (MAF), under the auspices of the Task Force on Rural Finance (TFRF). This study is part of the research activities under the framework of the ADA-LMFA partnership strengthening financial inclusion in Laos. Client protection and responsible finance are at the core of ADA, which in addition sought to analyze the impact of the COVID-19 crisis on microfinance institutions' clients within its global network, as ADA is much concerned by rising OID among MF clients in the countries where ADA operates[2].

The TFRF was established in 2019 under the Sub-Sector Working Group on Rural Development (SSWG-RD): the TFRF is co-chaired by DRDC and the Bank of Lao PDR (BoL) and aims to "provide policy options and recommendations for enhancing access to finance for rural communities and farmers supporting the overall effectiveness and relevance of rural development in Lao PDR"[3].
OID had been brought up in several meetings of the TFRF and was identified as an issue to look more into. The initiative was therefore joined by DRDC with support through LuxDev's Local Development Programme for Bokeo, Bolikhamxay, Khammouane and Vientiane Province (LAO/030).

The survey was carried-out by Enterprise Development Consulting Laos Ltd. (EDC), with Cedric Javary as team leader and report writer. The LMFA was instrumental as a liaison with the participating lender institutions, to ensure the representativeness and unbiased selection of the interviewed sample.

The consultants would like to warmly thank the LMFA and its members, the DRDC, the Financial Institutions Supervision Department (FISD) of the BoL and other stakeholders for their responsiveness and diligent cooperation to this study.

The views expressed in this publication are those of the author and do not necessarily reflect the views and policies of the TFRF or the SSWG-RD, or of the participating agencies/organizations.

[1] Note that since the finalization of this research the Department of Rural Development and Cooperatives (DRDC) is now called the Department of Rural Development (DRD) in accordance with the Decree on Ministry of Agriculture and Forestry Organizational Structure and Operations No. 60/PM issued on 15 October 2021.
[2] See www.ada-microfinance.org/en/COVID-19-crisis/initiatives-ada-crisis-mfi-and-clients.
[3] ToR of the TFRF, January 2019.

Executive Summary

The objectives of this survey on over-indebtedness (OID) among microfinance and village funds borrowers in Laos are to gauge the extent of the OID phenomenon, the patterns associated with OID borrowers, and the factors that led to OID situations. The survey would then provide practical recommendations to policymakers, lenders and foreign donors backing-up the lenders.

The survey consisted in desk research, ~100 informant interviews of lenders' operatives and stakeholders, the remote interview of 800 borrowers, 500 from Village Funds (VFs) and 300 from microfinance institutions (MFIs) over Q2 2021: the sample is considered representative for MFIs, but not for VFs with prominent VF promoters not participating. The survey could track only <u>subjective OID</u>, that is when the borrower feels s/he has to make sacrifices to the household living standards to repay the loan. The remote survey approach imposed by the COVID-19 crisis setting hindered the collection of reliable incomes and expenditure figures to compute households' actual loan repayment capacity, thus to determine <u>objective OID</u>.

The microfinance and village funds industry, though of limited size in macro-economic terms (its aggregated credit represents just 0.8% of the GDP, to be compared with 2.9% of GDP for the Lao leasing companies, and 26.5% of the GDP for the Cambodian microfinance industry), is crucial for access to finance in rural areas, deprived of credit from other sources (e.g., credit to agriculture is less than 8% of total bank credit). Microfinance and village funds would have a combined outreach to ~780,000 clients, showing their critical role for access to finance in rural areas which are underserved by larger formal financial institutions.

As a first of the kind demand-side survey on MFIs and VFs, the survey could describe the respective niches served by both types of lenders: ⅔ of MFI borrowers are urban while ¾ of VF borrowers are rural. Deposit-Taking MFIs (DTMFIs) and Savings & Credit Unions (SCUs) serve more up-market clients, evidenced by their higher average loan sizes (DTMFIs 32 million kip, SCUs 25 million kip) double that of VFs and Non-Deposit-Taking MFIs (NDTMFIs) at 16 million kip. This is reflected in the level of education of their clients – while ⅔ of NDTMFI and VF borrowers have lower secondary education or less, ⅓ of DTMFI and SCU borrowers have higher education. The type of collateral used is very telling: DTMFIs rely nowadays overwhelmingly on salary as collateral, what indirectly excludes women because they comprise just 38% of the salaried population, while VFs rely on land title. It is worth noting that youth is under-represented among both MFI and VF borrowers with the age bracket [18-30] representing just 15% of the clients.

The survey found an excessive proportion of subjective OID: 8% of MFI borrowers, and 4.3% of VF borrowers said they are currently struggling to repay – this would add up to 13.7% of MFI borrowers and 6.1% of VF borrowers who experienced repayment struggle at some point of the lifetime of their loans. High subjective OID is not correlated to larger loan sizes – except extremes over 50 million kip – and to higher interest rates, but it concentrates in loan duration outside the 'comfort' zone of both types of lenders: above 24 months for MFIs and above 12 months for VFs.

The COVID-19 crisis has only marginally increased OID: only 8% of the adverse events that affected VF OID borrowers were stated by them as COVID-related, and 28% of the adverse events that affected MFI OID borrowers. Shocks affecting borrowers are still the combination of extreme weather events and health/accident crises.

Importantly, the survey found very few instances of multi-borrowing, just 3.0% among MFI borrowers and 4.7% VF borrowers, which does not explain for OID: none of the OID MFI borrowers are borrowing from multiple sources, and it is the case for just 7.4% of OID VF borrowers. Borrowing from moneylenders is also negligible. A low level of education is no predicate of OID either: OID borrowers are even slightly more educated than non-OID borrowers. A vast majority of MFI OID borrowers are women (76% of OID MFI clients are women vs. 49% of non-OID MFI clients) while they are under-represented among OID VF borrowers; this insight would require further research for an explanation.

The survey showed an absence of correlation between OID and the supply-side indicator measuring late loan repayments, the Portfolio-At-Risk (PAR). For MFIs a low incidence of subjective OID can translate into a low PAR but not vice-versa. VFs tend to leave late borrowers off the hook, thereby mechanically reducing incidence of subjective OID; unless under the oversight of a Network Support Organization (NSOs) they don't produce PAR figures and are often too lax in the handling of bad debts by rolling them over systematically and never writing-off defaulting loans and frauds.

The conclusions and main recommendations from the survey are for:

- Policymakers
  - Linking MFI & VF lenders to the Credit Information Bureau (CIB) is not a priority as multiple borrowing is not the driver of OID in this sector. It is probably more optimal to focus the CIB on addressing the issues of OID with the banking and leasing sectors.
  - Little need to extend to the MFI sector the COVID-19 crisis prevention measures that are necessary to support the banking sector and relieve borrowers.
  - Oversee more carefully the segment of large loans (exceeding 50 million kips in size) in MFIs.
  - PAR is not a reliable proxy for OID: if OID is to be monitored, demand-side surveys remain the only tool available.
  - Financial literacy to avert OID should not be confined to people with low education level; strive to have financial literacy content also aimed at people with high education level.
- MFIs
  - Revisit product design to avoid overstretched loan durations >24 months to fit requested loan amount with actual repayment capacities.
  - Have systematically both spouses sign loan contract.
    The other spouse not consulted at all is noted for 27% of OID MFI borrowers.
  - DTMFIs: diversify from salary loan and re-target women.
- VFs
  - Loans of duration >12 months to include partial principal repayment at 12 months.
  - Need of up-to-date reporting and basic discipline to accounting.
    Write-off frauds and defaults.
  - Stop automatic roll-overs: consider rolling-over only if some of the overdues are recovered.

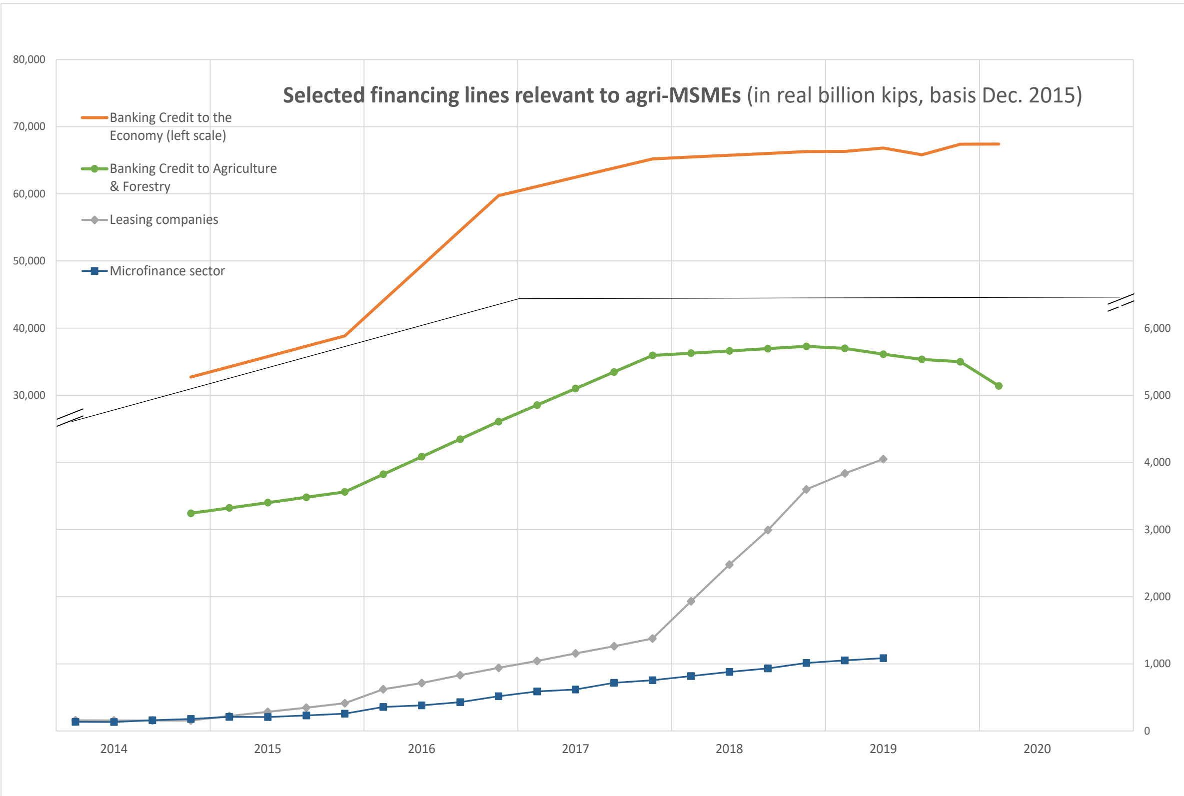
1 Introduction

1.1 Microfinance in Laos: undeveloped but important for underserved rural areas

Lao PDR is one of the few remaining Least Developed Countries of continental Asia and is still a predominantly rural society. Access to Finance is seen as a major constraint to inclusive economic growth and the supply of financial services to rural areas still lags behind.

The Government of Lao PDR (GoL) has historically promoted the microfinance sector to provide access to finance to rural areas and to poor people. In part due to regulatory limits to access to foreign equity and areas of operations, the sector remains scattered between numerous players (a total of 73 licensed MFIs[4]), none of them having reached nationwide scale (the most expansive MFI operates in 3 provinces out of 19). The aggregated loan outstanding of licensed MFIs represent a mere 0.8% of GDP, which is minimal compared with the Cambodian MF sector loan outstanding at 26.5% of the Cambodian GDP. As seen in Figure 1, foreign commercial capital has thus flooded the Lao leasing sector, which is not subject to foreign equity limitations, now financing 2.9% of the Lao GDP.

Figure 1: Selected figures on the financing of agriculture and rural areas



Source: BoL, leasing & microfinance data from ASIA SMALL & MEDIUM-SIZED ENTERPRISE MONITOR 2020, ADB October 2020

Indicates a superposition of different scale (left scale for bank credit, right scale for all other data points)

[4] Comprising 18 DTMFIs, 35 NDTMFIs and 20 SCUs, according to BoL website accessed 15 September 2021 (www.bol.gov.la/microfinance). The number of licensed MFIs peaked to 123 in September 2018.

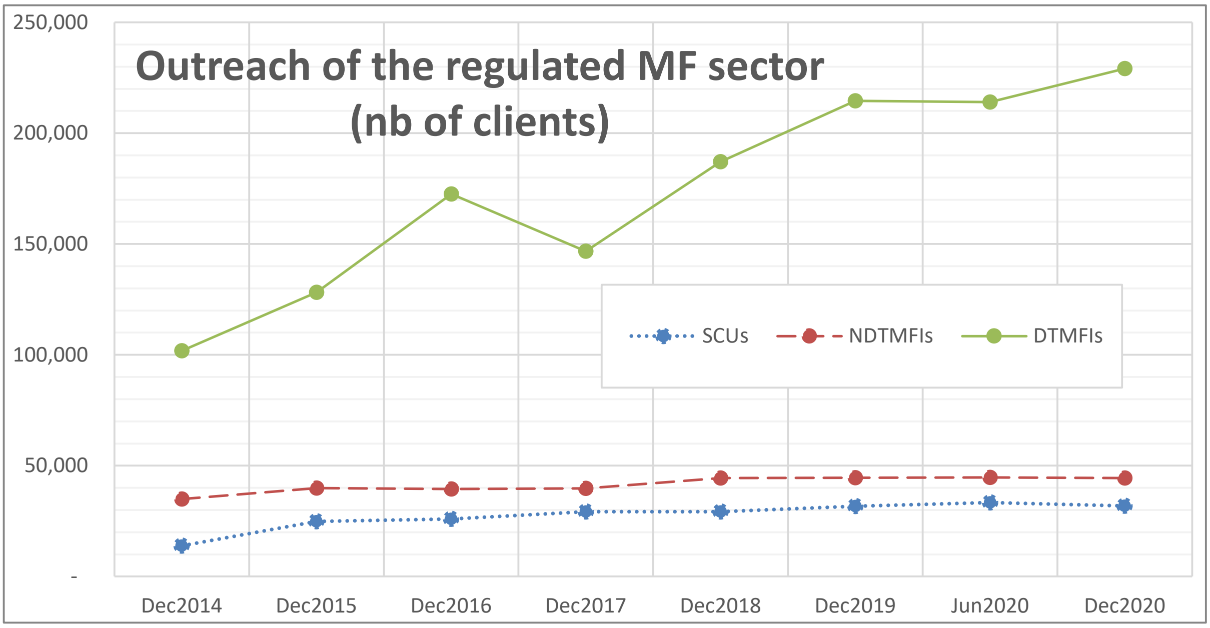
Figure 1 also shows the disinterest of the banking sector for the financing of agriculture: credit to agriculture stagnate at less than 8% of banking credit although agriculture contributes to 16% of GDP and employs 61% of the workforce.

1.2 Rapid typology of the microfinance sector at large

The formal microfinance sector comprises three types of institutions that were formalized in 2008:

- Deposit-Taking MFIs (DTMFIs): MFIs authorized to take deposits from the public and for this reason subject to several prudential ratios. They are the fastest-growing segment of the microfinance sector comprising the largest institutions, see Figure 2.
- Non-Deposit-Taking MFIs (NDTMFIs): subject to lesser scrutiny but hampered in their growth by the lack of access to refinancing, whether commercial or concessional.
- Savings & Credit Unions (SCUs): financial cooperatives providing services exclusively to their members who must buy at least one share and have equal vote at the General Assembly.

Figure 2: Outreach of the regulated microfinance sector by type of MFI



Source: LMFA, LMFA members data (covers ~90% of the regulated MF sector)

In parallel to the formal MF sector, GoL has encouraged the development of community-based ‘village funds’ that sprouted in the 1990s, which are semi-regulated: they are formally registered with district authorities but not with BoL. Village funds are either ‘top-down’ or ‘bottom-up’ depending on their source of capital:

- ‘Top-down’: Many development projects have attempted to address the perceived lack of funds for villagers’ income-generating investments by setting up grant-financed village revolving funds, either in kind or in cash. Additionally, Payments for Environmental Services (PES) and compensation payments have been used as incentive to initiate credit-based village funds. The capital for on-lending is provided by international donors and some GoL funds, and then revolved indefinitely between community members.
  In this survey, the ‘500 million kip’ village fund, operated by DRDC, is a typical example.
- ‘Bottom-up’: International donors led by GIZ on one hand and the Lao mass organization Lao Women’s Union (LWU) on the other hand have promoted a self-help group version of village funds whereby savings of the villagers are recycled into loans to village members. Concerned by the unsustainable management of numerous village funds to offer high yields to savers,

GIZ has introduced a stricter methodology with capital and liquidity buffers, and set up Network Support Organizations (NSOs) to backstop and provide oversight to the Village Banks[5] (VBs) it had initiated. The NSOs are themselves licensed by BoL as NDTMFIs or SCUs. This model of NSOs has been replicated by LuxDev and the WB for some areas (e.g. hydro-project in Nakai district of Khammouane province operated by the Nam Theun 2 Power Company Limited "NTPC"[6]), although with the significant difference on the origin of the lending capital, from the donor rather than from villagers' savings: both participate to this survey.

The GoL support to VFs has been reaffirmed in the Lao PDR Financial Inclusion Roadmap (FIR) 2018-2025 signed-off by the Governor of BoL in August 2018: "Strengthen village funds for sustainability and relevance to rural populations" is the third of the five pillars of this Strategy, with an outcome to "increase general access to financial services among adult population from 75% to 85% by end of 2025", and for adult women in the same proportion.

[5] GIZ insists on the label 'Village Bank' to differentiate them from the mainstream Village Funds, highlighting the increased safety offered to villager savings mobilized by stricter processes and the oversight by NSOs.
[6] See www.namtheun2.com.

2 Objectives

There is significant anecdotal evidence of over-indebtedness (OID) among farmers: the issue had been raised in the past even at the Agricultural Sector Working Group[7], and by civil society actors like the Lao Farmers Network. While inadequate lending practices from State-Owned Banks to farmers were then pointed at, the Lao MF sector has also received criticism of driving poor customers into OID because of its high cost of credit (compared to State-Owned Banks). In spite of the sensitivity of this theme, there has been no survey in Laos trying to quantify and/or characterize this phenomenon, as opposed to Cambodia for instance. This survey is therefore designed to provide an objective set of evidence to inform this debate: comprehensive insights, understanding and in-depth analysis on over-indebtedness (OID) prevailing in the microfinance sector at large, comprising both regulated (MFIs) and semi-regulated (VFs).

It seeks also to gauge the magnitude of the impact of the COVID-19 crisis on OID. The findings of this study are expected to inform the fine-tuning and design of financial services and also to improve and implement more strictly client protection mechanisms in the microfinance sector.

Operators can gain an analytical framework of their lending portfolio towards preventing their users to become trapped in over-indebtedness. Donors supporting the sector can gain an understanding of the situations leading to OID and prevent these, as part of their goal of building sustainable financial services providers under a no-harm paradigm. Regulators and policymakers can get a better understanding of the OID phenomenon, and therefore of the policy tools that may or may not prevent this. Secondly, they can get insights onto the handling of OID situations by lenders, whether abusively or not, with possible recommendations to deal effectively and humanly with OID situations.

The survey will therefore provide insights on three aspects:

- The level of indebtedness and borrowing patterns
    - Number of concurrent loans
    - Aggregated loan outstanding
    - Debt servicing capacity
- Factors that led to over-indebtedness or have prevented it
    - Specific loan products or lending modalities that are over-represented in OID
    - Unexpected events
- Actions needed to address situations of over-indebtedness

[7] See minutes of the Sector Working Group on Agriculture and Rural Development (SWG-ARD) meeting on 23 January 2016, 'Outcomes of the workshop held on farmers' indebtedness under the SSWG on Farmers and Agribusiness'.

3 Limitation of the study

This study encountered several limitations to bear in mind when reading the findings:

- Limited information and statistics were at hand to draw a sample representing accurately the population of borrowers from MFIs and VFs; the largest operators of VFs (LWU, WB Poverty Reduction Fund) declined to participate to the survey, thus severely limiting the population of VF borrowers to survey.
- The choice of a phone survey as opposed to face-to-face interviews at the borrower's doorstep enabled to carry-out the survey throughout COVID-19 related lockdowns in Q2 of 2021, but limited the survey to essential questions only and forced to drop surveying the borrower's and her/his household's incomes and expenditures quantitatively;
- Borrowers' responses could not be matched against the lenders' loan record on the borrower, nor the loan application files themselves. This could have shed light on the relationship between OID and the Portfolio-at-Risk indicator (PAR, see § Acronyms for definition), which is attentively followed-up by MFIs and their regulator BoL.

As a consequence, the interviewed sample of borrowers can be claimed to be statistically representative only for the subset of MFI borrowers, not for the much larger population of VF borrowers. Therefore, the findings are of a qualitative nature when pertaining to VFs. These limitations are developed in Appendix 1: Elaboration on the limitations of the survey.

4 Methodology

4.1 Proposed approach

Previous studies pertaining to OID, particularly the 2013 survey of OID in microfinance in Cambodia[8], combine two perspectives on OID, the *objective* one and the *subjective* or perceived OID.

OID occurs *objectively* when the household's monetary incomes cannot cover both household regular expenses and the regular instalments to repay the loan. The indicator of objective OID is therefore the ratio of regular debts instalments divided by monthly net positive cash-flow over the same period, that is the difference between monetary incomes and expenditures, measured at both individual and household's scope – the latter being most important given that assets are owned in general at household level (land, house and major equipment like car, motorbike, refrigerator, etc…). A common rule of thumb is that regular instalments should not exceed 30% of the positive cash-flow of the household for the period of reference. While a straightforward principle in theory, implementation is very difficult because it requires an accurate assessment of all inflows and outflows: it is very challenging as households do not have any written records of inflows and outflows (or a bank statement if the flows all pass through the bank account) and many informal jobs are not supported by written contracts, spelling out the amount and mode of remuneration (fixed and variable part of salary, piece work remuneration, compensation for overtime, etc.).

There is a situation of *subjective* OID when the borrower feels s/he struggles to repay his/her loan to the point that s/he is making frequent and unacceptable sacrifices impacting his/her living standards: it should be in theory matching the objective OID, but can notably diverge if incomes drop suddenly or become irregular, and the same for expenses, or if the borrower is worried of such events occurring. Uncertainty about future incomes and possible unexpected events, shocks, affecting in-flows and/or outflows, can be a great source of stress, certainly reinforced by a lack of information on the borrower's present level of incomes and revenues and on her/his current liabilities.

The survey attempted to identify differences between OID and non-OID borrowers through a vast number of dimensions: loan characteristics, demographics, economic activities, unexpected events encountered. These differences can then be probed for correlation, hence researched for possible causality or at least highlighted to serve as possible flags of high risks of OID.

The survey also investigated the loan application process, the post-disbursement processes, and the delinquent loan recovery processes, comparing whenever possible the recollection of the borrower with the methodology stated by the lenders' operatives (procedures stated by operatives often deviate from the procedures described in lenders' operations manuals). The idea is to research whether OID is prevalent where lenders' processes were not followed.

In addition, the survey sought to evaluate the level of enforcement of the key tenets of consumer protection standards, referring to the international benchmarks from the CERISE and Social Performance Task Force (SPTF)[9], and taken over integrally in the Code of Conduct of the LMFA (which must be formally endorsed by lenders to become members), with emphasis on the minimum of 'Transparency' and 'Fair and respectful treatment of clients':

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[8] Study on the Drivers of Over-Indebtedness of Microfinance Borrowers in Cambodia: An In-depth Investigation of Saturated Areas, Dannet Liv, Cambodia Institute of Development Study, March 2013

[9] See www.cerise-spm.org and www.sptf.org. International microfinance consumer protection standards were historically first formulated through the seven principles of the SMART campaign www.smartcampaign.org.

- Evaluate if the borrower was clearly informed of the product feature and of the repayment schedule.
- Attitude of the lender when default occurs and the 'fairness' of the loan recovery process.

4.2 Design of the survey sample

The rigor of the survey rests on an unbiased representativeness of the sample interviewed of the MFI and VF clients at a national level. This implies to ensure to the largest extent possible a random selection of the borrowers within the selection criteria determined to achieve national representativeness and to avoid any selection bias from the concerned institutions (favoring client groups without repayment problems):

- Receive the extensive list of borrowers from concerned institutions and EDC to determine the randomized interview order.
- For the largest MFIs, select clients from branches with level of PAR in line with the average of that MFI.

The requirement for the ex-ante thorough list of borrowers proved very challenging to the execution of the survey. It took ~1.5 months to collect the complete list of borrowers from the selected institutions. To contain the administrative burden LMFA and EDC decided to interview a minimum of 4 clients per individual MFI and per village fund.

The survey endeavored to replicate with maximum detail the characteristics of the MFIs and VF clients at a national level leveraging detailed sectorial data from LMFA:

- Distribution of clients by type of MFI (DTMFI, NDTMFI, SCU) and by type of VF (VBs/VCSs).
- Distribution of clients by gender.

The representativeness of the distribution by province was not possible by lack of disaggregated background data:

- No prior data was available on the distribution of microfinance clients by province. EDC mitigated this lack by balancing the surveyed sample of borrowers for the largest MFIs over the provinces of residence of the respective borrowers.
- The VF GIZ-NERI survey 'Microfinance in Lao PDR' May 2015 and Finscope Laos 2014 did not provide data points by province[10].

4.3 List of activities

Design of the survey:

- Desk research on literature, statistics and data sets pertaining to the MF sector and the VFs in Laos.
- Clarification with LMFA management and possibly involved development partners (GIZ-AFP, LuxDev, ADA) of the methodology in the ToR (see §1.2).
- Drafting of questionnaires for clients and informants.
- Analysis of previous nationwide surveys covering demand-side and supply-side data on MFIs and VFs to stratify more precisely the group of MFIs and VF clients to build a representative sample.
- Research in detailed reports that MFIs and VFs can produce on all their borrowers (possibly with the entire loan history) for instances of overdues

[10] The Finscope Laos 2014 survey has a limited number of respondents (2,048 nationwide, with only 1% adults currently borrowing from MFIs and 4% from VF).

    - Microbanker for Windows (MIS used by nearly all MFIs in Laos): search for detailed (possibly financial and non-financial) transactions report on loans if it states the overdue balance, or other reports in MB-Win reporting module, for export to Excel by MFIs and e-mail to LMFA
    - EDC liaised with GIZ-AFP, LuxDev's Rural Development LAO/030 Programme and MAF/DRDC to identify similar reports for VFs
- Stakeholders' workshop to get consensus/validation on the goals of the survey, the detailed methodology and the questionnaires.

Execution of the survey:

- Initial training of the 3 LMFA enumerators.
- Testing of the survey design in Vientiane Capital with the participation of the 3 LMFA enumerators
    - Selection of respondents based on reporting shared by MFIs and VFs
    - Test of both borrower and informant questionnaires
    - Test of encoding of borrower questionnaire alongside institution's data on borrower
- Interview of informants by MFIs Engagement Expert, with Team Leader for regulator and experts based in Vientiane.
- Collection by LMFA of the extensive list of borrowers from its members. Selection of interviewees by EDC based – when provided – on transmitted institution's transaction records, to generate a randomized order within criteria for overall representativeness.
- Phone interviews of borrowers by EDC enumerators, divided into 2 sequences:
    - Layer 1 for all borrowers, covering sections:
        - Respondent & household demographics
        - Farming /agriculture
        - Incomes & expenditures
        - Borrowing & credit
        - Unexpected events & debt distress
        - If no situation of OID, proceed to loan application process
    - Layer 2 interview for borrowers who stated past or ongoing subjective OID. Carried-out exclusively by EDC supervisors given the sensitivity. Covers:
        - Control on Borrowing & credit
        - Debt distress section in detail
        - Loan application process
        - Savings
    - Quality assurance by EDC's supervisors of enumerators: reinterview remotely ~20% of borrowers over the next 2 days (layer 2 interviews included). Focus mainly on accuracy of amounts stated by borrowers.
- Automated encoding of the borrowers interviews encoders (enumerators recorded responses in electronic KOBO forms)
    - Expansive consistency checks of encoded questionnaires by EDC data proof-readers
- Manual encoding of interviews of Key Informants.

Analysis of results and final report:

- Quantitative analysis of borrowers and managers databases of questionnaires →production of initial report.
- Stakeholders restitution workshop.
- Final report.

4.4 General characteristics of the surveyed sample

Only the distribution or clients by lender participating to the survey was strictly controlled. Other important variables for the survey, e.g. place of residence and gender of borrower, could be controlled only ex-post, see Table 1 and Table 2.

Table 1: Gender repartition in surveyed sample vs. contextual data

Type lender	% Female borrower in surveyed sample	Contextual data	Source
DTMFI	44%	43%	LMFA, LMFA members data, December 2020
NDTMFI	71%	61%	
SCU	53%	55%	
MFIs (3 types)	*52%*	*48%*	
VF	37%	65%	Finscope Laos 2014

While the surveyed sample matched supply-side data for MFIs thanks to the exhaustiveness of data compiled to elaborate the surveyed sample, the gender level is completely off the mark for VFs: the reason is that the main promoter of VFs, the Lao Women's Union, catering in priority to women, opted-out of the survey (see § 3).

Table 2: Repartition of surveyed sample by province vs. overall population (LSB, 2020)

Province name	English	% interviewed	%Σ population
ສະຫວັນນະເຂດ	Savannakhet	11%	15%
ນະຄອນຫຼວງ ວຽງຈັນ	Vientiane Capital	6%	12%
ຈຳປາສັກ	Champasack	23%	10%
ຫຼວງພະບາງ	Luangprabang	3%	7%
ວຽງຈັນ	Vientiane	3%	7%
ສາລະວັນ	Saravan	11%	6%
ຄຳມ່ວນ	Khammuane	2%	6%
ໄຊຍະບູລີ	Xayabury	8%	6%
ອຸດົມໄຊ	Oudomxay	5%	5%
ບໍລິຄຳໄຊ	Borikhamxay	2%	4%
ຫົວພັນ	Huaphanh	1%	4%
ຊຽງຂວາງ	Xiengkhuang	2%	4%
ບໍ່ແກ້ວ	Bokeo	4%	3%
ຜົ້ງສາລີ	Phongsaly	1%	3%
ຫຼວງນ້ຳທາ	Luangnamtha	12%	3%
ອັດຕະປື	Attapeu	7%	2%
ເຊກອງ	Sekong	1%	2%
ໄຊສົມບູນ	Saysomboun	1%	1%

The footprint of MF and VFs is very uneven across Laos, hence significant variances with population figures. The over-representation of the provinces of Champasack, Saravan and Luangnamtha owe largely to the significant footprint of GIZ VBs in these areas.

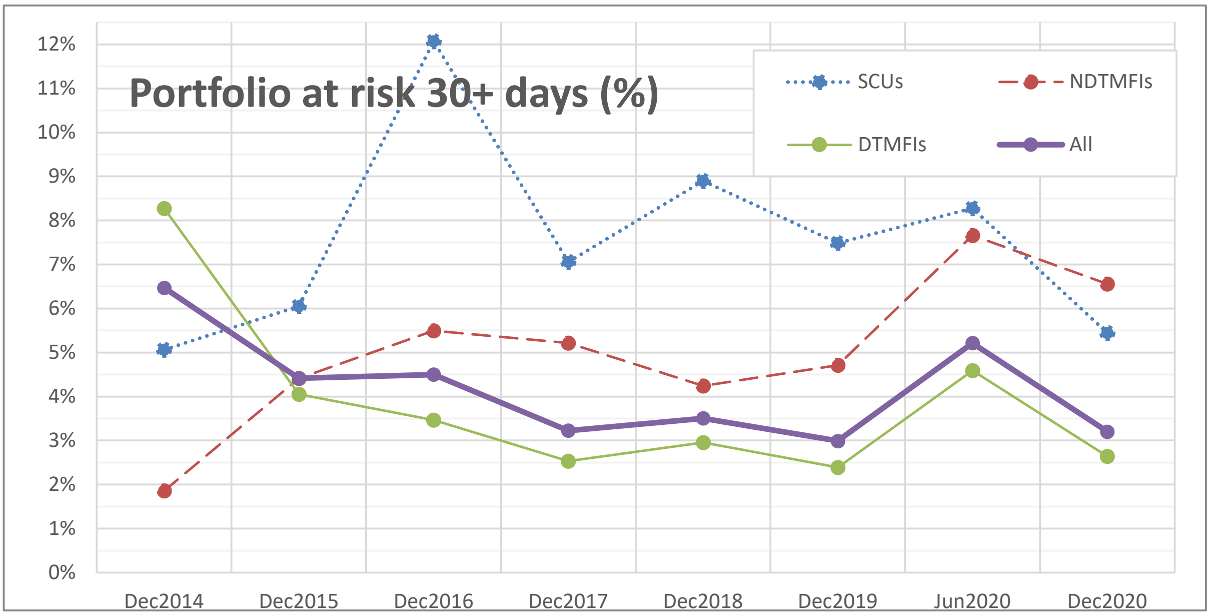
5 Results

5.1 Disconnect of objective and subjective OID in Lao MF

The survey states a level of subjective OID at 8.0% in regulated MFIs, way above PAR levels (the only proxy available for objective OID) and subjective OID in surveyed VFs, at 4.3%. Figure 3 below shows that since 2017 the MF industry as a whole has managed to contain PAR to the internationally accepted sustainability level of 3% - even a regulatory obligation in Lao PDR for all financial institutions. Regulated MFIs observe transparency in reporting diverging PAR, so the study doubts any deliberate attempts to conceal PAR spikes. The impact of the COVID-19 crisis is felt only on the levels of PAR as of June 2020, as it coincided then with the first wave of nationwide lockdowns, April-June 2020; by December 2020, most MFIs had managed to return to pre-COVID levels.

LMFA has not yet data fitting the timeframe of interviews, i.e., 2nd week of April, May and June 2021, which took place during the 2nd wave of nationwide lockdowns, so the PAR reported to LMFA as of June 2020 seems an acceptable proxy.

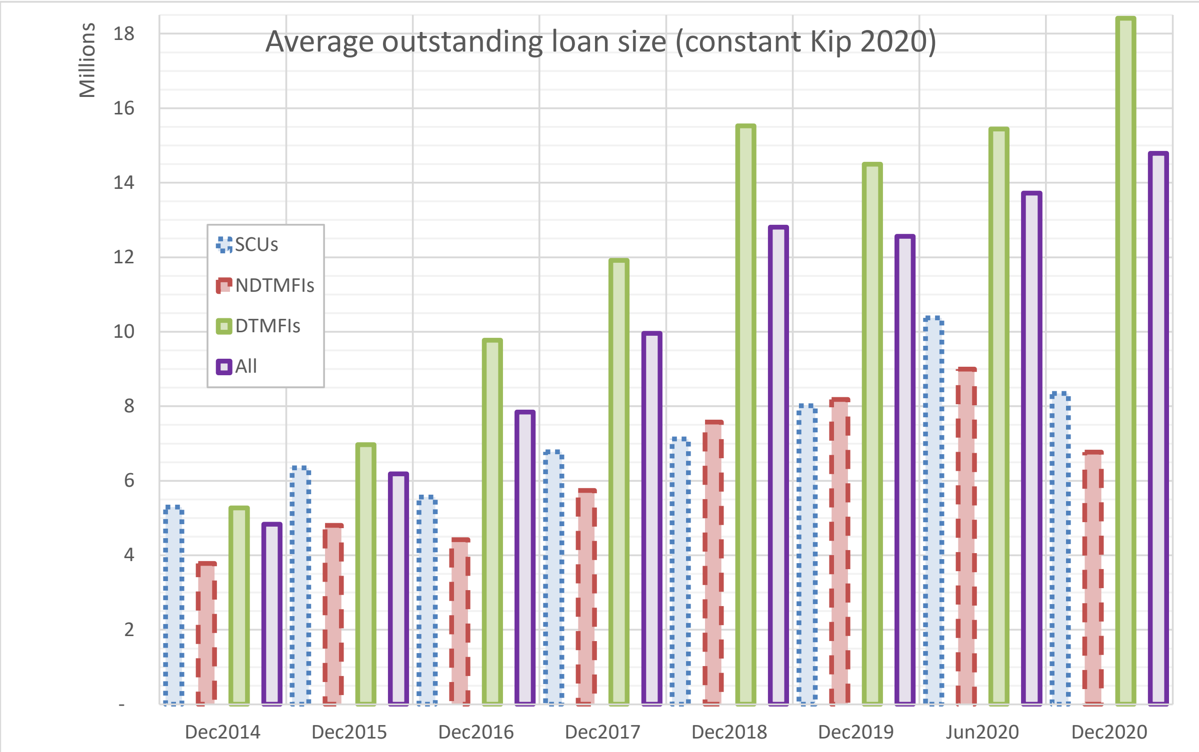
Figure 3: Evolution of PAR in the regulated MF sector, by type of MFI



Source: LMFA, LMFA members data

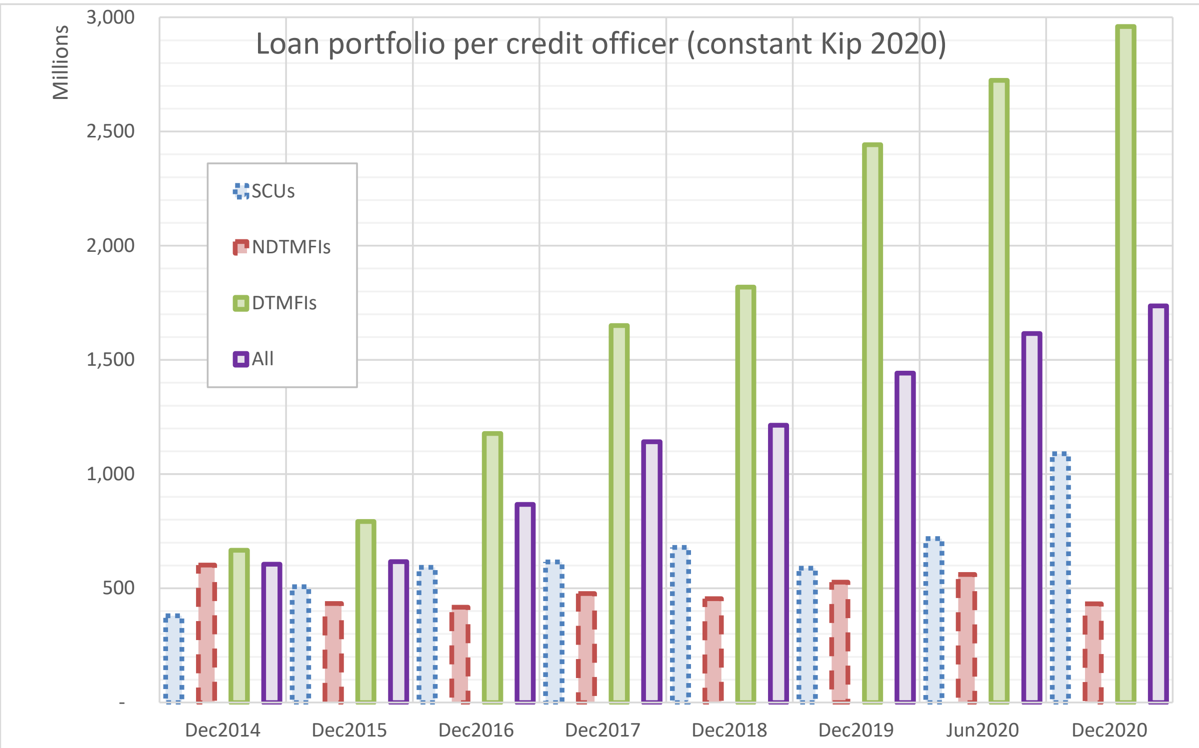
DTMFIs maintaining acceptable levels of PAR through the 1st year of the COVID-19 crisis is no such small feat, particularly considering the ever-growing size of loan outstanding (Figure 4) and loan portfolio per credit officer (Figure 5) even more increasing as it is also combined with productivity gains (more borrowers per credit officer). Meanwhile SCUs and NDTMFIs contained excessive PAR levels by reducing loan outstanding per borrower, now reaching half of the level of DTMFIs.

Figure 4: evolution of average loan outstanding by type of MFI



Source: LMFA, LMFA members data

Figure 5: evolution of the size of credit officer's portfolio by type of MFI



Source: LMFA, LMFA members data

A further comparison down to lender level between PAR reported to LMFA and subjective OID (ongoing and over) shows an absence of correlation: Table 3 shows that MFIs without borrower in ongoing OID tend to have a lower PAR, but at the other end of the spectrum MFIs with no PAR may have a large portion of borrowers interviewed who have experienced subjective OID. *Of course, this observation is to be taken cautiously given the very small size of the interviewed sample for each lender (column 'Borrowers itw'd' – lenders with less than 5 borrowers interviewed have been deliberately excluded from this table).*

Table 3: Comparison PAR with subjective OID by lender

Ref	Type lender	Name lender	Promoter	PAR June 2020	PAR Dec 2020	Subjective OID ongoing + over	subjective OID over	subjective OID ongoing	Borrowers itw'd	% Loan Out-standing in
20	DTMFI	Champa Lao		3.8%	4.4%	50%	17%	33%	6	79%
108	VF	SCU Nakai/NTPC	WB	0.0%	0.0%	40%	0%	40%	10	57%
36	DTMFI	Oudomxay Development		20.%	5.1%	37%	21%	16%	19	44%
6	DTMFI	EMI		3.4%	1.1%	23%	14%	9%	22	19%
101	VF	Homsabphattana (NSO)	GIZ	2.5%	0.0%	15%	6%	9%	65	29%
102	VF	Hongsa-Ngeun Distict (NSO)	GIZ	30.%	30.3%	9%	9%	0%	11	5%
24	DTMFI	Champasack		6.4%	3.5%	6%	3%	3%	33	6%
35	NDTMFI	Non Xayniom (XMI)		1.9%	2.6%	6%	0%	6%	17	4%
104	VF	Savandankham (NSO)	GIZ	5.7%	0.0%	6%	0%	6%	35	12%
105	VF	SCU Vanmai (NSO)	GIZ	0.0%	0.0%	5%	0%	5%	56	12%
32	DTMFI	Saynhai Samphanh		0.1%	0.1%	4%	0%	4%	49	3%
106	VF	SCU Champa Phatthana (NSO)	GIZ	0.0%	5.4%	3%	2%	1%	92	1%
107	VF	Thavisab (NSO)	GIZ	6.4%	0.0%	3%	0%	3%	36	2%
21	DTMFI	Sinsabmeuangneua		0.9%	0.6%	0%	0%	0%	14	0%
103	VF	Khob-Xienghorn (NSO)	GIZ	0.0%	2.9%	0%	0%	0%	20	0%
109	VF	VCS/LuxDev	LuxDev	#N/A	#N/A	0%	0%	0%	10	0%
110	VF	VCS/LuxDev	LuxDev	#N/A	#N/A	0%	0%	0%	10	0%
114	VF	DRDC 500 million kip	DRDC	#N/A	#N/A	0%	0%	0%	50	0%

Source: LMFA members data for PAR data & OID survey

The interview of lenders' operatives shows also very divergent perceptions of OID, even within the same institution. To gauge OID among their clients, senior managers of MFIs would most often

[11] For each lender, ratio of aggregated loan outstanding of borrowers stating subjective OID (over and ongoing) divided by total loan outstanding of interviewed borrowers from that lender.

resort to PAR. Otherwise, operatives' estimates of OID prevalence are quite dispersed in the range 3%-60%, and rarely align with their borrowers' perception (note the important caveat of the very limited interviewed sample per lender). Interestingly the perceived prevailing OID level in the community (all lenders including, also banks) is not a factor influencing perceived OID among their clients. Operatives cite more often the MFIs than banks to be negatively affected by high overall OID.

A few operatives stated candidly a high level of OID among their clients while they deem overall very low OID prevailing in their client's communities – implying they do a poor job at screening their clients. However, there is consensus that sectors identified at greatest risks of OID are hospitality or/and trade, sectors that were most affected by the travel restrictions and lockdowns imposed by Government to contain the spread of the COVID-19. On the opposite, VF managers very often state an absence of OID, in line with their borrowers' perception.

5.2 Subjective OID at less than half the MFI level in VFs

VFs demonstrate a significantly lower level of subjective OID, at only 4.3% for the interviewed sample (Table 4). Adding past difficulties, 13.7% of MFI borrowers and 6.1% of VF borrowers experienced stress at some point in repaying their loans.

Table 4: Subjective OID and loan sizes by type of lender

Type provider	Number of interviews	Subjective OID over + still	Subjective OID over	Subjective OID still	Loan size Average	Loan size Median	Loan tenure (months)
DTMFI	180	13.6%	5.9%	7.7%	28,270,000	28,000,000	29.3
NDTMFI	76	13.8%	6.2%	7.7%	13,826,000	10,000,000	14.7
SCU	36	14.3%	3.6%	10.7%	22,679,000	16,500,000	20.1
3 types MFIs	*292*	*13.7%*	*5.7%*	*8.0%*	*24,089,000*	*20,000,000*	*24.4*
VF	500	6.1%	1.8%	4.3%	13,302,000	10,000,000	14.0

Source: EDC MF borrower interviews, Q2 2021

In the absence of supply-side data on VFs, information on loan sizes, duration and current debt outstanding are available only for the interviewed sample. These terms are strikingly similar between VFs and NDTMFIs: average loan size at 13+ million kip and its median at 10 million kip, relatively shorter tenure at 14 months. DTMFIs have the highest loan size, with the average loan outstanding at 28 million (way above supply-side data at 18 million kip, see Figure 4): repayment capacity is adjusted with a much longer tenure, twice of VFs at 29 months. SCUs demonstrate very dispersed loan sizes with the average way above the median value.

Low frequency of principal repayment is definitely not a feature of any of the MFI lenders surveyed: principal is repaid in regular (weekly or monthly) installments in nearly all cases. Note that in contrast nearly all VF loans have repayment of principal at the end of the loan (see §5.5.2 below). VF operatives of LuxDev and DRDC 500mn kip rightly observe the absence of OID among their beneficiaries. GIZ NSOs managers recognize the presence of late loans but cannot tell if it is a sign of OID (the average GIZ VF loan size is aligned with the VF average). They are concerned by the risk of OID stemming from concurrent loans from the Policy Bank Nayobay, but the Nayobay Bank loan outstanding of the interviewed sample from GIZ (n=315) represents less than 1% of the VF credit outstanding (but debt of GIZ VF members with MFIs represents 11% of the VF credit outstanding; all other outstanding debts amount to just ¼ of the VF credit outstanding – note that this includes also credit from GIZ VF members not borrowing anymore from GIZ VFs).

5.3 Dominant traits of OID borrowers – borrowing patterns

This section compares the two groups of OID borrowers (subjective OID, over and ongoing) vs. non-OID borrowers, with a subdivision by type of lender: the results don't show decisive points but nonetheless debunk commonly heard opinions from practitioners, e.g. that OID is due to the limited education of borrowers or that male borrowers have inherently less repayment discipline than female borrowers. *Beware of the very small size of the OID sample, particularly when it comes to NDTMFIs and SCUs: only very large discrepancies are therefore highlighted.*

5.3.1 Multiple borrowing limited and not a trait of subjective OID

The most important finding is related to the case of multiple borrowing, commonly pointed as the main cause for OID: borrowing from multiple lenders is rare at DTMFIs and NDTMFIs, but less so at VFs and SCUs (see cells highlighted in yellow in Table 5). Strikingly, none of the OID clients from MFIs are borrowing from multiple sources (see cells highlighted in purple in Table 5). Only OID VF borrowers are more prone to multi-borrowing than non-OID VF borrowers – still they remain an exception: 7.4% as opposed to 4.5% for non-OID VF borrowers (see cells highlighted in grey in Table 5).

Table 5: comparison of credit between OID and non-OID borrowers

OID status	Type provider	Nb itw	Total outstanding debt **Average**	Total outstanding provider credit **Average**	Total initial debt **Average**	Loan size **Average**	Loan tenure (months)	% multi-borrowing
both	DTMFI	180	19,582,000	17,849,000	31,624,000	28,270,000	29.3	1.8%
both	NDTMFI	76	11,836,000	9,678,000	15,712,000	13,826,000	14.7	3.0%
both	SCU	36	16,953,000	15,541,000	25,516,000	22,679,000	20.1	9.7%
both	*3 types MFIs*	*292*	*17,350,000*	*15,575,000*	*26,957,000*	*24,089,000*	*24.4*	*3.0%*
both	VF	500	12,882,000	11,141,000	16,017,000	13,302,000	14.0	4.7%
Yes	DTMFI	27	30,881,000	27,175,000	48,160,000	36,261,000	26.4	0.0%
Yes	NDTMFI	9	12,671,000	10,959,000	13,189,000	13,189,000	24.1	0.0%
Yes	SCU	5	12,912,000	12,912,000	20,500,000	20,500,000	26.4	0.0%
Yes	*3 types MFIs*	*41*	*24,692,000*	*21,876,000*	*37,110,000*	*29,274,000*	25.9	*0.0%*
Yes	VF	27	26,145,000	30,000,000	32,352,000	32,500,000	21.5	7.4%
No	DTMFI	153	17,647,000	16,380,000	28,792,000	27,012,000	29.8	2.1%
No	NDTMFI	67	11,706,000	9,473,000	16,103,000	13,929,000	13.4	3.4%
No	SCU	31	17,552,000	15,979,000	26,259,000	23,042,000	19.1	11.1%
No	*3 types MFIs*	*251*	*16,049,000*	*#DIV/0!*	*25,092,000*	*23,029,000*	*24.1*	*3.5%*
No	VF	473	11,987,000	21,315,000	14,915,000	26,455,000	13.6	4.5%

It is possible that a portion of the multi-borrowing behavior from OID VF clients stems from an attempt to handle precisely the OID status, rather than a behavior leading to it.

The lag time between the 1st layer interview and the 2nd layer interview was significant: ~30 days for DTMFI clients, ~40 days for NDTMFIs and SCUs, 55 days for VFs. It clearly shows a sudden though modest increase of multi-borrowing among the OID sample.

In sharp contrast to Cambodia, the recourse to moneylenders in the community is very rare: only 2 instances among 792 responses and for limited amounts (20 million kip and 3 million kip initial debt with moneylender, respectively in addition to two loans from SCUs of 100 million and 25 million). The follow-up interview of OID borrowers (minding the lag time) shows no recourse to moneylenders when struggling with debt (the two instances popping-up were not new moneylender loans: these are rather small loans taken way before the interview, they probably were omitted during the 1st interview).

5.3.2 Loan sizes and high interest rates not correlated to subjective OID

Table 6 shows the surprising absence of correlation between loan size and OID – except for loan sizes above 50 million kip that show significant repayment struggles across all lenders. OID is felt across all brackets of loan sizes.

Table 6: OID in relation to loan size

		VFs				MFIs			
Initial loan size		Subjective OID				Subjective OID			
min.	max.	over + ongoing	over	ongoing	currently borrowing	over + ongoing	over	ongoing	currently borrowing
50,000,000	∞	67%	17%	50%	6	30%	10%	20%	10
45,000,000	50,000,000	0%	0%	0%	9	10%	5%	5%	21
40,000,000	45,000,000	0%	0%	0%	4	13%	13%	0%	8
35,000,000	40,000,000	0%	0%	0%	5	11%	4%	7%	27
30,000,000	35,000,000	17%	0%	17%	6	15%	15%	0%	13
25,000,000	30,000,000	0%	0%	0%	21	11%	6%	6%	35
20,000,000	25,000,000	14%	7%	7%	14	7%	0%	7%	14
15,000,000	20,000,000	6%	0%	6%	36	17%	6%	11%	35
10,000,000	15,000,000	18%	6%	12%	33	13%	0%	13%	23
5,000,000	10,000,000	4%	1%	3%	119	15%	4%	10%	48
0	5,000,000	3%	1%	1%	145	12%	8%	4%	52

Research of correlation between OID and interest rates did not point to any correlation, even when factoring in the interest repayment burden, i.e. interest rate times loan outstanding or initial loan size depending on the type of interest rate (flat or declining). Table 7 shows that OID is constant at VFs across all interest rate brackets, and with MFIs is uneven but not necessarily concentrated in the higher range of interest rates.

Table 7: Relationship between interest rates and OID

		VFs				MFIs			
monthly interest rate		subjective OID				subjective OID			currently
min.	max.	over + still	over	still	currently borrowing	over + still	over	still	borrowing
6.0	∞	0%	0%	0%	0	25%	0%	25%	4
5.0	6.0	0%	0%	0%	8	11%	5%	6%	64
4.0	5.0	5%	0%	5%	20	18%	0%	18%	17
3.0	4.0	7%	2%	5%	170	6%	4%	2%	51

2.0	3.0	6%	2%	5%	65	17%	9%	8%	66
1.0	2.0	6%	3%	3%	120	13%	4%	9%	56
0.0	1.0	0%	0%	0%	9	33%	33%	0%	3

Monthly interest rate: 'flat' rates, i.e. interest applied to the initial size of the loan as opposed to the loan outstanding (in that case 'degressive' rates apply), were multiplied by 2 to reflect their impact on the cost of credit.

5.4 Dominant traits of OID borrowers – demographics

OID and non-OID borrowers have been tested against all variables of demographics in the questionnaire: gender and age for both the borrower and head of household, marital status, education level, number of household members and their proportion (minors, adults, elderlies). Several results challenge the conventional wisdom:

- A low level of education is not a predicate of OID. A sharp difference in education level is to be noted between VF clients (⅔ have lower second education or less) and MFI clients (only ⅓), but without any impact on the OID status. On the contrary, higher education is somewhat over-represented in the OID group: there is a higher proportion of people with higher education in the group of OID borrowers as in the group of non-OID borrowers.
- Marital status and size of household make no difference on OID status.
- Age of borrower makes no difference either. The age bracket 18-30 tends to be slightly less in OID across all providers.

But the gender of the borrower makes a difference in the case of MFI clients: 76% of OID MFI clients are women vs. 49% of non-OID clients. Strikingly it is not the case for VF clients: 38% of non-OID VF clients are women vs. 33% of OID VF clients.

Ethnicity bears some influence over OID, but this matters only to VF, as MFIs have few borrowers from ethnic minorities (just 20% of their clients – because MFI clients are more urban and in formal salaried employment): ethnic minorities account for nearly 60% of OID VF borrowers, vs. an average of 45%.

5.5 Separate consumers niche and lending patterns by type of lenders

5.5.1 MFIs and VFs cater to different customer niches

Table 8: Urban/rural divide in customer niches

	Subjective OID					
Types areas	over + still	over	still	Currently borrowing	from MFIs	from VFs
Urban	13%	6%	7%	288	63%	35%
Rural with year-long road access	7%	2%	5%	391	26%	72%
Rural without year-long road access	6%	0%	6%	17	24%	76%

Source: Urban/rural using the classification of the Lao Statistical Bureau (LSB)

A further deep dive in the survey results shows that MFIs and VFs also cater to different borrowing needs and types of borrowers:

- Table 8 shows that ¾ of VF clients live in rural areas. Therefore, it is not surprising that VF clients' reasons for borrowing are predominantly for agriculture: buying farming equipment

and farming inputs are both top reasons (>40%), buying livestock 17%.
Reasons #3 and #4 are business startup/expansion (22%) and covering living expenses in absence of cash income (21%).

- By contrast ⅔ of MFI clients live in urban areas. MFI clients borrow #1 for business startup/expansion (40% - even 60% for NDTMFIs) and covering living expenses in absence of cash income (34% - even 57% for NDTMFIs).
  OID MFI borrowers tend to even more borrow for business startup/expansion at 53%, the only significant variation when comparing OID and non-OID customers regarding reasons for borrowing.

Several reasons could be cited: the average of number of reasons is ~1.8 with little variation between type of lender and OID status.

5.5.2 Different lending terms MFIs vs. VFs

Table 4 above showed very different loan sizes and tenures by type of lender. VFs lend predominantly in loan sizes of up to 10 million kip: ⅔ of VF borrowers. Loan sizes from MFIs are very evenly distributed up to 50 million kip: by comparison with VF, only ⅓ of MFI loans are below 10 million. Loans above 40 million come mostly from DTMFIs.

Both groups of OID and non-OID borrowers, simply separated in the MFI (DTMFI, NDTMFI, SCU) category vs. the VF category, were then compared across their main lending characteristics: loan size, interest rate, duration. The type of repayment (bullet repayment where all the loan principal is repaid at the end as opposed to regular repayment of principal in installments) was not compared because the MFIs use predominantly the installments repayment of principal while VFs still tend to go for a 'bullet' principal repayment in full at the end of the loan term.

Bullet loans are typically fit to finance an agricultural cycle: finance the inputs and get the principal repaid when the harvest is sold; meanwhile the borrower repays regularly the interest on the loan outstanding. Typically bullet loans' tenure is of less than a year. Bullet loans are easier to manage from the lender's perspective especially in the absence of a Management Information System (MIS) as is typically the case of VFs. The downside is the difficulty to foresee repayment difficulties.
The column 'Loan tenure' in Table 4 shows also the average duration of loans per provider. In addition, MFIs show a surprising concentration of OID when the loan duration exceeds two years: the indicator of current OID ('still') is of greater meaning than past OID ('over') that would mechanically rise as the tenure of the loan extends.

Table 9 shows that ⅔ of VF loans are of duration of up to 1 year vs. only ⅓ for MFI loans. Most striking is to see MFI loan durations extending way beyond the traditional 2-year boundary, representing now 40% of the number of loans. The VF loans show an issue of OID when they exceed the 1-year threshold duration, with cells highlighted in dark orange in Table 5 showing an average duration of VF loans of 21.5 months for OID borrowers vs. 13.6 months for non-OID borrowers. No conclusion can be made for VF loans of more than 25 months because their number is too small to have any significance.

MFIs show a surprising concentration of OID when the loan duration exceeds two years: the indicator of current OID ('still') is of greater meaning than past OID ('over') that would mechanically rise as the tenure of the loan extends.

Table 9: OID in relation to loan duration by type of lender

	VFs: Subjective OID			VFs	MFIs: Subjective OID			MFIs
Loan duration	over + still	over	still	% nb loans	over +still	over	still	% nb loans
>48 months	18%	0%	18%	3%	20%	12%	8%	9%
37 – 48 months	25%	25%	0%	1%	18%	7%	11%	10%
25 – 36 months	6%	3%	3%	8%	18%	7%	11%	20%
13 – 24 months	10%	2%	8%	24%	7%	0%	7%	28%
≤12 months	4%	1%	2%	64%	12%	6%	5%	33%

The type of collateral used points to very different loan products:

- The main type of collateral for MFIs is the salary (63%), even 81% for DTMFIs demonstrating that salary loans is now their killer product, way ahead of land title (18%). Other types of official documents (IDs…) are nearly as used at 13%.
  Salary collateral is slightly underrepresented among OID borrowers showing that in itself salary loan is not a driver of OID.
- VFs still predominantly rely on land titles (80%), alternatively on official documents (IDs…). Interestingly VF OID borrowers are all characterized by the use of land title as a collateral, none by the use of official documents: is there too much emphasis on assessing collateral value to underwrite loans at VFs?
- Where the gender of the borrower makes a difference is in the type of collateral used. Table 10 shows the collateral by order of popularity (total is above 100% as several collaterals may be required by a lender) with the percentage of female borrowers in each case.
  It demonstrates that among the most used types, salary is much less accessed by female borrowers: only 39% of borrowers using salary as collateral are women. Anecdotally, the absence of collateral requirement is more frequent for men than women.

Table 10: type of collateral used, percentage of women borrowers concerned

Type collateral	Overall use	% female borrowers
1. Land or dwelling	52%	43%
5. Salary	27%	39%
6. Documentation (ID, Passport, Other)	16%	52%
9. No collateral required	6%	38%
2. Motor vehicle	6%	55%
7. Cash, Gold, Jewelry	4%	30%
4. Other household asset	2%	64%
8. Future earning power	1%	67%
3. Farming equipment	0%	

While gender differences are slim for many questions, one has a significant gap: salaried work. Among those with a full-time salaried work, only 36% are female. And not surprisingly, the record of borrowers with a full-time salaried work is with DTMFIs (81% of DTMFI borrowers) vs. 30% for NDTMFIs, 61% for SCUs (mind the several SCUs within state-owned enterprises or civil servants groups), dropping to a mere 19% for VF borrowers.

6 Analysis of results

6.1 Adverse events and COVID-19 impact on OID

Table 11 lists the adverse events that affected the interviewees over the last 12 months by order of prevalence in the whole interviewed sample. The list has events non-COVID related at its top, with a sharp contrast between VF and MFI clients, reflecting the rural/urban divide, for once where rural areas prove far more resilient; in particular the proportion of adverse events COVID-related is not higher for OID clients vs. the rest, or remains low in the case of VF borrowers. Observers will see the classic combination of extreme weather events (draughts, floodings, harvest failures often related through proliferation of pests and plant disease, or frost in highlands) driving OID for VF clients and emergency health issues. These problems could be mitigated by insurance, resilient infrastructure and farming techniques, but the microfinance industry cannot do much alone to mitigate these. Economic woes play a rather marginal role, and those closely related to the COVID-19 crisis do not come to the fore – except a job loss in the household that affected 22% of VF borrowers.

Table 11: Adverse events affecting borrowers

OID status	OID & non-OID		OID		non-OID	
Type of lender	MFIs	VFs	MFIs	VF	MFIs	VF
Nb unexpected events	1.7	1.7	2.6	2.7	1.5	1.6
% COVID-related	28%	8%	29%	16%	28%	7%
Harvest failure or losses of crop harvest (incl. plant disease)	24%	45%	24%	63%	24%	44%
Drought, poor rainfall or loss of access to water for farming	21%	43%	24%	70%	20%	41%
Illness within your household or family that requires medical expenses	21%	22%	39%	37%	18%	22%
Flooding / storms	12%	17%	12%	7%	12%	18%
Death or illness of livestock	10%	12%	10%	19%	10%	11%
Low selling prices - e.g. rice, floor prices, or prices buyers are prepared to pay	14%	9%	24%	15%	12%	8%
Competition - everyone is selling - difficult to sell own goods/products	12%	7%	29%	15%	10%	6%
Rise in prices of goods and services (incl. transport, electricity, groceries, interest rates)	18%	2%	29%	4%	16%	2%
Loss of job - self or household member or relative	8%	5%	12%	22%	8%	4%
Kept your job but salary not paid or sharply reduced or paid with much delay	7%	1%	5%	4%	7%	1%
Loss/failure of your business	5%	2%	17%	0%	3%	2%
Death/disability of other family member not main income earner	2%	3%	5%	4%	2%	3%
Death/disability of income from main income earner	3%	1%	5%	4%	3%	1%
Loss of your savings	3%	1%	5%	4%	3%	1%
Separation or divorce	2%	0%	10%	0%	1%	0%
Fire or destruction of your home or dwelling	0%	1%	2%	4%	0%	1%
Fire or destruction of household property	1%	0%	5%	0%	0%	0%

Having to pay unforeseen school/education fees	1%	0%	2%	0%	0%	0%
Loss of your land or access to land you use	0%	0%	0%	0%	0%	0%

Shocks that affect predominantly women are loss of land, destruction of property, then divorce (⅔ of those citing it are female, note its overrepresentation in OID MFI clients), then business failure (61% of those citing it are female).

Interviews of VF operatives on the ground confirm the near absence of COVID-19 crisis on OID, highlighting that many agricultural communities were barely impacted by the COVID-19 crisis.

6.2 Information of consumers and loan contract formality

Borrowers state to have been fully informed of all loan terms, with the following items checked individually: loan term, repayment schedule, interest rate. There are just a few who claim not to have been informed of the consequences of late repayment (6% for MFI clients, 2% for VF clients) and of the conditions of advanced repayments (9% for MFI clients and among them ¼ of SCU borrowers, 2% for VF clients) – these percentages are even smaller among OID clients. Information from VF operatives is cited as near perfect.

Operatives unanimously state that they have given these details in written, except the conditions for advance repayment (stated only by ⅓ of operatives). Only 1 interviewed borrower out of 792 claimed not to have understood the loan contract (and was not in OID).

The spouse is fully consulted by the borrower in 90% of cases, but for OID MFI borrowers the spouse was not consulted at all in 27% of cases (this is not happening with VF OID borrowers). It is corroborated by the fact that the MFI loan contract is not signed by both spouses in 30% of the cases while only 18% of cases for VF loans.

6.3 Lenders processes

6.3.1 Information collected on loan applicant: MFIs vs. VFs

The loan sanctioning process is worlds apart between VFs on one end and MFIs on the other. VFs document summarily the loan application process and do not perform verification: they rely on community members reciprocal knowledge, and considering the low prevailing level of OID and the small sizes of loans it can be considered good enough. That said, verification processes are needed for the not negligible instances of large loan sizes (consider those above 20 million kip): is it first a case of mission drift? Should there be a verification by an instance above, either the NSO or the district coordinator in these cases?

The MFIs are in a totally different setting, with what is claimed to be a very thorough credit assessment. The interviews of operatives show the order of importance of inputs for the credit assessment exercise (Table 12):

Table 12: Inputs to credit assessment by MFI operatives

Item credit assessment		Deemed 'Most important'	Collected spontaneously
Objective of loan		88%	100%
Personal income		84%	100%
Past loan repayment history		82%	100%
Pledge-able assets: value		82%	96%
Household other debts		76%	100%
Possible guarantor		73%	100%
Credit Information Bureau record		73%	88%
Projection of income improvement from loan		69%	100%
Pledge-able assets: title		65%	92%
Household expenses		63%	100%
Household income		57%	100%
Household assets		43%	96%
Irregularity/Seasonality of income		43%	96%
Reputation of requester in community		41%	100%
Safety deposit		35%	92%
Repayment meetings attendance rate		27%	45%

Source: OID survey, Key Informants Interviews

The data collection is very thorough (or is claimed to be), and the order of importance of inputs is not to be disputed, apart perhaps from the lack of focus on the scope of the household (the primary unit for OID because of assets ownership mostly at household level and likewise aggregation of debts) and on business projections that may put off investments in productive assets.

The verification is claimed by all MFI operatives (just a single exception) for: Reality of income-generating activity, Reputation check with neighbors, Household incomes & expenditures, Household assets. 90% of operatives declare to pay ALWAYS a visit to the credit applicant's home. In no case is the credit decision left to the discretion of the credit officer alone, let alone an MFI volunteer.

VF operatives don't undertake such verifications as they claim that they are implicitly known to the community. NSO operatives don't have the same approach but it is difficult to know whether they relate to the NSO's own retail activity or to the practice of the VFs under their responsibility.
That said, the recollection of the loan application process by the interviewed borrowers shows a contrasting view: out of the 12 listed information items[12], interviewees cited an average of ~9.5 items asked, except for DTMFIs borrowers who were asked only 6.3 items in average. It isn't necessarily contradictory as DTMFIs offering salary loans often get firsthand information from the borrower's employer, thus may not need to interview extensively loan applicants.

[12] See questionnaire J4 "Did the loan officer ask for?" for information items asked to borrower: Personal income /Household income /Irregularity-Seasonality of income /Household expenses /Household other debts /Household assets /Objective of loan /Projection of income improvement from loan /To visit your home or business premises /To see business records /Interview your neighbors and or village chief about you

6.3.2 Specific policies for longer loan tenures?

§ 5.5.2 showed that all loans face significantly higher rates of subjective OID as durations extend beyond the respective 'comfort zones' of VFs (1-year) and MFIs (2-year).

At VFs bullet repayment is probably too risky when the loan is extended over more than one year: it may call for an obligation of repaying part of the principal in each year of the loan, even if it is more complicated to follow-up (or alternatively ban tenures of more than one year, with the implicit understanding of flexibility in the timing of the final repayment).

However, the observation of higher subjective OID as loan duration extend beyond the common 2-year duration (in MF industry practice globally) is perhaps the indication of over-stretching the loan size to fit with modest repayment capacities or irregular income flows.

In all instances borrowers should be informed of possibilities of early repayment of principal with a sensible trade-off between deterring the use of this option and liquidity management considerations.

6.3.3 Processes after loan disbursement

Post-disbursement verifications never occur at VFs (NSO operatives state the opposite but we don't know if they refer to monitoring of VFs or simply to their own retail activity), and in average at the MFIs with higher OID.

The situation is more contrasted at MFIs with post-disbursement visit to the home of the borrower: some exclude it because they have effectively ring-fenced late repayments through other means (case of market leader Sayyaisamphan) and experience moderate OID; those who state to perform it always tend to have collectively higher OID than those who perform it sometimes.

More embarrassing is the lack of extensive information given to the borrower about the status of her/his loan repayment (outstanding balance, next instalments, possibilities & conditions of advance repayment): the response is always 'some', no operative declared to provide comprehensive status information.

Penalties for late repayment are enforced at all MFIs and NSOs but are never implemented at VFs: if it reduces pressure on the existing borrowers (and therefore mechanically reduces subjective OID) it also limits the revolving of the lending capital within the community. Loan rescheduling is naturally an alien concept to VF operatives (but not in the apex NSOs!) since the repayment terms are flexible and late repayments do not incur penalties.

Loan rescheduling is widely practiced by MFIs though there are notable exceptions (Sayyaisamphan, EMI). However, it remains rare to trigger rescheduling before defaulting, the overwhelming majority is after default. The lack of proactivity of the lenders is confirmed by the OID borrowers: ¾ mentioned that the lender did nothing when they were struggling to repay (80% of VF lenders, 66% of MFI lenders), just 8% were proposed to reschedule their loans (mostly the MFI lenders).

Table 13: Reactions of the lenders to OID borrowers (n=69)

1. No reaction	73%
2. Proposed to reschedule loan /extend loan term	8%
3. Asked to borrow money from somewhere else to repay the loan	8%
4. Threatened you	5%
5. Took your collateral	2%
6. Claimed overdues from guarantor or other family member or community member	2%
7. Went to authorities to repossess collateral	0%

These replies need to be nuanced with the verbal statements collected for responses [4-5]: the threats were made to go to the authorities to take some collateral (note it was not proposed to the late borrower to sell him/herself a collateral for repayment. The one instance of response [6] was to 'Suggest to sell the motorbike for the repayment of both principal and interest'. The only case of threat not related to collateral was with a VF borrower threatened with a 20% interest increase if s/he doesn't pay (small VF loan at stake of just 3.5mn kip taken in January 202, but the client had a 4-year loan with APB of 10mn with term October 2020).

7 Conclusions

7.1 VFs and MFIs catering to different types of consumers

This survey is the first close-up demand-side survey on the Lao microfinance sector at large: it therefore sheds a very useful light on the respective niches of clients and loan use cases from the various types of lenders included.

VFs and MFIs serve very distinct populations: rural clients for VFs who are mostly borrowing for agriculture, as opposed to the more urban MFI clients who borrow for several reasons, but very rarely for agriculture. Among MFIs, the salary loan is now the dominant product, at least for credit volumes: it explains most of the expansion of MFIs into larger loan sizes (⅔ of loans are in the range of 10-50 million kip – the regulatory microfinance loan ceiling used to be 10 million kip until April 2016[13]), somewhat coupled with longer durations. Interest rates are higher at MFIs than VFs, but the reduction of interest rates is very notable in the MFI sector.

VFs and MFIs are also systems in sharp contrast: VFs tend to have a more informal operating way relying on the respective knowledge of community members for the credit assessment, and also a very simple lending methodology, constrained by the limited ability of VF operatives to manage their credit portfolio and accounting. While MFIs of each category (SCU, DTMFI and NDTMFI) tend to have a relatively harmonized business model and processes, VFs are extremely heterogeneous, with a sharp difference between promoters providing capital for credit with a rather light-touch approach to oversight and data aggregation, and the GIZ Access to Finance for the Poor project attempting to combine the best of both the VFs and MFIs approaches (VFs under the supervision of NSOs registered as SCUs or NDTMFIs) and building the lending capital out of the savings of community members. While the surveyed sample of MFI borrowers is nationally representative, the results on the sample of VF borrowers cannot be extrapolated to the national level: several promoters opted-out because they were not able to technically provide the extensive supply-side data on their base of borrowers required by the survey methodology.

7.2 Too high prevalence of OID, but difficult to characterize

Although no take-aways can be shared regarding the prevalence of objective OID (measurement of repayment capacity in relation to the size of the loan instalment), the relatively high prevalence of subjective OID should be a cause of concern for all stakeholders: 13.7% of MFI borrowers and 6.1% of VF borrowers have experienced stress at some point in repaying their loans. At the time of interviews, it was then the case for 8.0% of MFI borrowers and 4.3% of VF borrowers.

This high prevalence of subjective OID is probably endemic, § 6.1 showed the limited negative impact of the COVID-19 crisis felt by the borrowers, even those in OID.

7.2.1 What OID among MFI clients is not about

This survey may not provide definite answers on predicates of OID, but decisively excludes several conventional wisdom points.

- Most importantly OID does not arise from multiple borrowing.
  Concurrent multiple borrowing is still fairly limited among MFI clients, and DTMFIs seem to actively screen borrowers along these lines.

[13] See BoL's Implementation guidelines of Decree on Microfinance Institutions dated 19 April 2016.

- OID is not linked to a low level of education – OID borrowers tend to be slightly more educated than borrowers without repayment problems.
- PAR cannot be used as a proxy for subjective OID, and there is no way to measure on a large-scale objective OID (it requires a rigorous assessment of the household income levels).

Some common wisdom observations received a 'qualified' confirmation:

- OID increases with the size of credit: lenders with lowest credit sizes experience no subjective OID. The situation is very contrasted between lenders with high credit sizes: some, like DTMFI Saynhai Samphanh, experience no OID in spite of a large average loan size at 20+ million kip (for other DTMFIs with even higher average loan size the sample interviewed is too small to draw any conclusion).
  But in general, only loans with size exceeding 50 million kip are characterized by very high OID.
- The COVID-19 crisis seems to be deteriorating only marginally the repayment capacities of the concerned borrowers

7.2.2 Women progressively disenfranchised from Lao microfinance at large?

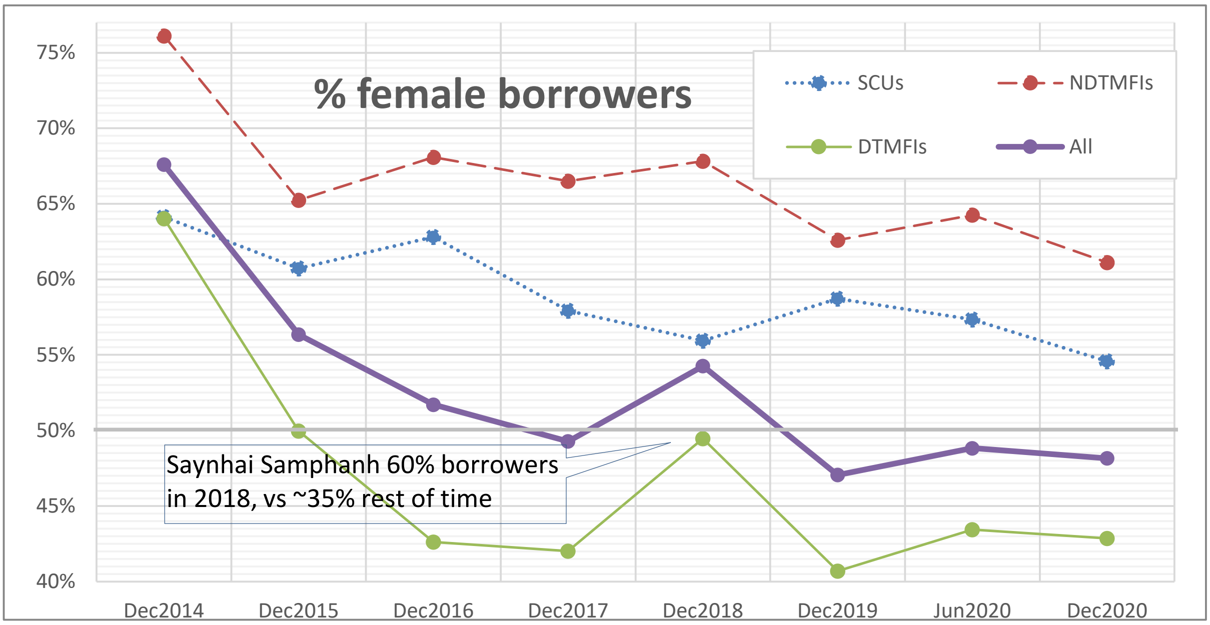
Gender is a surprising factor of OID, defying also conventional wisdom: OID MFI borrowers are overwhelmingly women, defying the bias that women borrowers tend to be more conservative, thus unlikely to default. The research team has no hypothesis to explain this insight, further studies would be needed to either confirm or infirm this finding or browsing through Credit Information Bureau data on defaulting MFI borrowers (CIB did not share any statistics following its meeting with LMFA on OID).

This observation chimes with an unwelcome trend of the Lao MFI sector that sees the reduction of the proportion of women to less than half of all borrowers since 2017[14], across all types of MFIs but most abrupt with DTMFIs, see Figure 6. The main reason at hand is the growing share of the salary loans across all types of MFIs but principally the DTMFIs: salary loans outcast many women for the simple reason that women are under-represented in salaried occupations. In that sense, the gender repartition of salaried employees in the surveyed sample at 38% female /62% male matches exactly the gender repartition of the nationwide Labour Force Survey 2017[15].

[14] The punctual rise in 2018 is certainly due to an inaccurate data entry related to #1 DTMFI Saynhai Samphanh.

[15] See LAO PDR LABOUR FORCE SURVEY 2017, Lao Statistics Bureau, June 2018 with ILO support, Table 34. 'Percentage distribution of employment by status of employment, province, geographic area and sex'.

Figure 6: Historical outreach of the MFI sector gender wise



Source: LMFA, LMFA members data (covers ~90% of the regulated MFI sector)

However, gender is a neutral parameter for VF borrowers when it comes to OID. But again, the sample surveyed showed a weak proportion of female borrowers (just 37% of VF borrowers). Not involving formally both spouses in the loan decision, formalized by both spouses' signature on the loan contract is also increasing the risk of OID as was underlined with MFIs (see § 6.2).

7.2.3 Longer loan terms associated with rising OID

§ 5.5.2 and § 6.3.2 discussed the issue of loan duration in relation to OID: it is clearly the parameter of lending condition that is most correlated with OID. VFs with loan tenure above 1 year and MFIs with loan tenure above 2 years both experience a jump in OID prevalence.

7.3 Is VF better performance over MFIs on subjective OID such a good sign?

Undoubtedly VF clients are twice as less prone to OID than MFI clients. Several factors explain for this situation, but this survey is unable to rank their level of importance among:

- #1 Lower loan sizes
- #2 Shorter loan durations
- #3 Knowledge of borrower and of the loan's business case
- #4 Lender's level of loan contract enforcement

VFs definitely are much more prudent lenders vis-à-vis factors #1 and #2. On factor #3, living close to applicants give VF managers an edge but probably make them overlook crucial borrower information like multiple borrowing, quite often pre-existing (while MFIs experience lower levels of multiple borrowing).

Factor #4 matters definitely: VF operatives rarely do not exert much pressure on late borrowers, who therefore don't feel in OID while they should. But there is certainly much variation across VFs and promoters; still, the practice is widespread of simply rolling-over the debt for another year, quite often adding to it overdue interest payments. Several instances of the largest VF loans are in fact personal liabilities by former VF operatives who defrauded their VF by pocketing loan repayments from other borrowers. Factor #4 is certainly an element of explanation for the lack of correlation between PAR and OID.

8 Recommendations

8.1 Towards policymakers

This study has important findings that can help policy-makers prioritizing short-term action:

- Linking MFI & VF lenders to the CIB is not a priority as multiple borrowing is not the driver of OID in this sector. It is probably more optimal to focus the CIB on addressing the issues of OID with the banking and leasing sectors.
- Little need to extend to the MFI sector the COVID-19 crisis prevention measures that are necessary to support the banking sector and relieve borrowers.
- Oversee more carefully the segment of large loans (exceeding 50 million kips in size) in MFIs[16].
-

For the longer term and with respect to the FI Roadmap agenda, the policymakers need to engage with the MFI industry to address the growing gender gap in access to credit: how to diversify from the salary loan that has become the main product of the MFI sector (still bewildering that commercial banks cannot take the most prominent role in this niche). The FI Roadmap has a target of increased access to financial services among adults from 76% to 85% for both men and women. The only women-friendly access channels were MFI and VFs: if women targeting recedes there, will banks make up for the loss?

Incentives could be developed to entice MFIs to get back to their historical pro-gender mantra: tie the growing volume of subsidized credit to the MFI sector from different government credit lines (SME Fund, COVID-19 relief fund, Lao Access to Finance Fund) to specific gender outreach targets or include some NDTMFIs as recipient since they remain so much more gender-oriented (see Table 1). Another case for the longer term is to push VF promoters for regular monitoring and data aggregation: supply-side data from large VF promoters except for GIZ and LuxDev is outdated and not double-checked, preventing from assessing the evolution of the footprint of VFs.

Financial literacy to avert OID should not be confined to people with low education level; BoL should strive to have financial literacy content also aimed at people with high education level as they tend to be over-represented in the OID borrowers' segment.

8.2 Towards lenders and their promoters or supporting donors

Loans of size above 50 million kip deserve a specific attention because of the high OID concentration there: it is suggested that the loan sanctioning process is reinforced with the requirement of sign-off by a higher management level (if not the case already) and that HQ of lenders randomly follows-up by phone with this segment of borrowers to check for subjective OID.

Loans of longer tenures, beyond the comfort zone of VFs (1-year term) and MFIs (2-year term), also deserve a special attention: is it for intrinsic business reasons or to maximize the loan size in the view of modest household's cash flows? In any case, VFs extending such long terms should ensure at least an annual collection of principal to avert a stress on cash-flow when the loan reaches maturity.

[16] Reporting of MFIs to BoL used to include a schedule on large loans (exceeding 5% of equity, hence >10 million kip for DTMFIs which was the ceiling for micro-loans). Current reporting on late loans is simply per sector and along gender: adding reporting on aging of large loans could help monitor this risk (anyway need to monitor that 80% of the loan portfolio is composed of micro-loans, currently with a ceiling to 50 million kip).

8.2.1 Specifically for VFs

Promoters of VFs need to tackle rigorously the lack of accurate and up-to-date reporting, and bring some basic discipline to accounting. They cannot take comfort in the lower rate of OID as it is also the sign that many late borrowers are left off the hook – with the consequence that other villagers in need of credit will be denied access. The basic vade mecum of financial rigor needs to be enforced at the grassroots even if it entails a painful reckoning:

- Frauds and defaults have to be written-off, rather than being tracked within the overall client portfolio. Overdue interest cannot be accrued to the loan portfolio: it should be tracked separately.
- Automatic roll-overs should be stopped: a partial overdue recovery should be the pre-requisite for any roll-over.

8.2.2 Specifically for MFIs

In the short-term MFIs should have systematically both spouses to sign loan contract as the other spouse not consulted at all is noted for 27% of OID MFI borrowers (see §6.2).

In the longer-term MFIs ought to reflect on how to reverse the gender gap in their client base which would imply to diversify from salary loans that by definition cater to a gender-imbalanced segment.

9 Appendix 1: Elaboration on the limitations of the survey

9.1 Limited information to build a perfectly representative sample of MFI & VF borrowers

The study was hampered by missing supply-side data:

- Lack of sectoral data on OID:
    - BoL neither shared data on credit risk (PAR) for the non-bank sector, nor for the regulated MF sector
    - CIB did not share data on OID from the non-banking sector, in terms of extent of coverage and detected incidence of OID.
- Lack of any data on the VF sector as a whole and incomplete participation
    - No compilation of VF sector data since the 2015 GIZ-NERI VF survey (based on end 2013 data) or the Finscope Laos 2014 demand-side survey that established an outreach of VF sector to 9.3% of the adult population (9.3% for savings services and 2.8% for credit; vs. 1% outreach for the regulated MF sector).
      Promoters' data of VFs often lacks probing by lack of an administration for oversight: VFs that have become insolvent may still show their books of outstanding loans since overdue loans are never provisioned, thus overstating outreach.
    - Major promoters of VFs, LWU and WB Poverty Reduction Fund bowed-out: it proved too difficult for them to collect extensive borrowers list of funds established under their auspices. Therefore, the sample of VFs is largely skewed towards 'bottom-up' VFs and VFs with close oversight: the results may not be extrapolated to the whole VF sector which is extremely heterogenous.

As a consequence, the representativeness of the interviewed sample could not be controlled along external data sources. Some ex-post assessment of representativeness is indicated in § 4.4.
Limitation to the demand-side data must also be acknowledged:

- Choice of phone interviews to accommodate the geographical spread within the budget constraints and risks of travel restrictions due to GoL COVID-19 infections prevention measures (the contemplated workaround of delegating the administration of the survey to volunteers from MFI/VF staff had downsides in terms of quality of results).
  This choice turned-out later to be a wise move when nationwide lockdown measures were reinstated from mid-April onwards.
  Phone interviews have important shortcomings:
  - limitation in the number of questions (must keep the interview to 30 minutes maximum while it takes longer to administer the questionnaire),
  - inability for surveyor to probe immediately answers with visual observation at the interviewee's household, or contextual information gleaned in the village.
- Notorious lack of reliability of income amounts gathered in surveys, for a credible analysis of sustainability of debt servicing, all the more in a remote setting under time constraint.
  Getting supplier data is a possible workaround but it cannot be performed on a large scale to compare OID vs. non-OID borrowers
  →focus instead on number, type and frequency of income sources to identify patterns where OID is over-represented

9.2 Analyzing ex-post loan applications for information asymmetries causing OID

Getting institutional data on the interviewee could shed profound insights on the drivers of the credit decision, particularly for instances of OID not stemming from a crisis after loan disbursement:

- Understand the parameters of the loan underwriting decision to compare them with the present parameters and also with the client's recollection of her/his financial situation at the time of loan application
  - Were possible repayment difficulties voluntarily under-estimated?
    If so, by whom? Client or credit officer?
    this would then be linked with informant interviews to assess the robustness of institutional loan sanctioning processes: review of application by manager and by credit committee.
- Divergence in the loan utilization vs. loan application
  Again, verify the existence of loan utilization check by the institution after disbursement
- Perform a comparison case by case between PAR and OID: are all OID clients currently late on their loan or not? Is PAR significantly or only marginally higher with OID clients vs. non-OID clients? *To be meaningful the records would need to exactly synchronized (lenders record must be of the month of the interview of the OID borrower).*

While the survey design initially contemplated to perform a review of the loan application files vs. layer 2 responses for all borrowers who stated OID, this undertaking was dropped for two reasons:
- Inability to complement interview data with records on borrowers from the supply-side: patchy records and the multiplicity of record formats at MFIs hindered this endeavor.
- The significant workload onto participating lenders to retrieve all loan application files for those in OID, to then compare with the responses of the borrowers to look for discrepancies, and possibly reinterview the borrowers.
  It would have been particularly taxing on the VFs, or possibly lacking any input data because loan application is quite often not documented.
- The need to draw a control sample to identify whether the discrepancies are widespread or not, and a predicate of OID or not.

This research could be envisaged as an add-on to this survey – provided there are enough lenders interested and willing to cooperate.