Annex B. Sector Assessment

Sector Assessment, Strategy and Roadmap

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

The rural and microfinance sector of the Lao People's Democratic Republic

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Abbreviations and acronyms

ABC	ACLEDA Bank Cambodia Plc.
ABL	ACLEDA Bank Lao Ltd.
ACLEDA	Association of Cambodian Local Economic Development Agencies
ADB	Asian Development Bank
AEC	Asian Economic Community
AFP	Access to Finance for the Poor (GIZ program, supports FISD)
AFTA	ASEAN Free Trade Area
AGL	Allianz General Laos
APB	Agricultural Promotion Bank
ASR	Sector Assessment, Strategy and Roadmap
ASEAN	Association of South East Asian Nations
BFSD	Bank and Financial Institution Supervision Department (former department of BOL)
BOL	Bank of the Lao PDR
BSD	Bank Supervision Department (of BOL)
BSRP	Banking Sector Reform Program (ADB program)
CIB	Credit Information Bureau (division of BSD)
CMP	Catalyzing Microfinance for the Poor (ADB project, worked with MFId)
CODI	Community Organizational Development Institute
CPI	Consumer Price Inflation
CSP	Country Strategy and Program
D-DG	Deputy-Director General
DG	Director General
DOS	Department of Statistics (part of MPI)
DT MFI	Deposit Taking MFI
etc.	et cetera, "and the rest"
FIAM	Foundation for Integrated Agricultural Management
FIDS-2020	Financial Institution Development Strategy for Lao PDR from 2009 to 2020
FISD	Financial Institution Supervision Department
FSP	Financial Service Provider
GA	Governance Agreement
GDP	Gross Domestic Product
GIZ	Gesellschaft für Internationale Zusammenarbeit (German organization for international cooperation)
GNI	Gross National Income
HRD	Human Resource Development
IAS	International Accounting Standards
IBA	International Banking Advisor
ICA	Investment Climate Assessment
IFC	International Finance Corporation (part of World Bank group)
INGO	International Non-Governmental Organization
KN	Kip (the national currency of the Lao PDR)
Lao PDR	Lao People's Democratic Republic
LDB	Lao Development Bank
LECS	Lao Expenditure and Consumption Survey
LPRP	Lao People's Revolutionary Party
LPFI	Lao Postal service Financial Institution

Lux Dev	Luxembourg Agency for Development Cooperation
LWU	Lao Women's Union
MAFIPP	Making Access to Finance more Inclusive for Poor People (UNCDF program, works with FISD and BOL)
MF	Microfinance
MFI	Microfinance Institution
MFId	Microfinance Institution Division (former division of BFSD)
MIC	Ministry of Industry and Commerce
MOF	Ministry of Finance
MPI	Ministry of Planning and Investment
MPSAP	Microfinance Policy Statement and Action Plan
NBB	Nayoby Bank
NBFI	Non Bank, non insurance Financial Institution
NEM	New Economic Mechanism
NERI	National Economic Research Institute (part of MPI)
NLCRDPE	National Leading Committee for Rural Development and Poverty Eradication
NPL	Non Performing Loan
NSEDP	National Socio-Economic Development Plan
PSB	Phongsavanh Bank
PMO	Prime Minister's Office
RFSDP	Rural Finance Sector Development Program (ADB program)
RMF	Rural and Microfinance
SBFIC	Savings Bank Foundation for International Cooperation
SCU	Savings and Credit Union
SME	Small and Medium Enterprise
SMEPDO	Small and Medium Enterprise Promotion and Development Office (Part of Ministry of Industry and Commerce)
SOCB	State Owned Commercial Bank
TA	Technical Assistance
UNCDF	United Nations Capital Development Fund
VMLF	Village Managed Loan Fund
VRLF	Village Revolving Loan Fund
VSLF	Village Saving and Loan Fund
WB	World Bank

Currency Equivalents

National Currency in the Lao PDR: kip (KN)

In this report $ refers to United States dollar.

KN1=$0.00013
$1.00 = KN8,000

EXECUTIVE SUMMARY

Definition and objective of rural and microfinance. The Policy Statement on the Development of a Sustainable Rural and Microfinance (RMF) Sector issued by the government of the Lao PDR defines RMF as the provision of a broad range of financial services, including but not limited to cash-based credit, deposits, insurance and money transfers to low-income households and their micro enterprises (microfinance) and to people and enterprises in rural areas (rural finance). The Policy Statement explains RMF's objective is to enable low-income and rural households to deal with socio-economic shock, smooth income and expenditures, connect monetarily and utilize economic opportunities. The Policy Statement embeds a holistic view on RMF sector development aimed at building a sustainable financial system consisting of a diverse set of RMF providers, including but not limited to banks, non-bank financial institutions and microfinance institutions (MFIs), both privately and publicly owned. Significantly, it stipulates these providers require autonomy in their management, in hiring procedures, in setting interest rates, in finding access to capital, and choice of products, clientele and geographical areas. The view embedded in the Policy Statement is congruent with that of ADB and the issuance of the Policy Statement has been at the basis of ADB's assistance to RMF sector development in the Lao PDR.

RMF's customers' relevance for economy, income and employment. The market for RMF services in the Lao PDR is large and comprises over 80% of its population. The structure mainly determining Laos' social organization, the household, is also its main production base. Of the one million households in which the 6.1 million people live, 68% are located in rural areas and generate income by combining agriculture with various other productive activities.[8] The closer to urban areas, the better the infrastructure and the easier the access to markets, the more the additional productive activities develop into real "micro enterprises". Laos has 280,000 household-based enterprises, 84% operating without staff, 99% operating with a maximum of four household members and 66% with not more than two household members. Labor productivity of non-agricultural activities is higher and as a consequence micro enterprises raise people's income. Overall, 85% of the workforce generates income in a self-employed setting, either with a centre of activities in farming (more in rural areas) or in micro enterprises (more in urban areas). This part of the economy is informal yet provides income for most and has an estimated value of a third of total GDP or some $1.9 billion. Main constraints identified for the growth of micro enterprises are access to finance, followed by the burden of (unfair) taxation practices and issues related to accounting, administration and registration, or formalization.

Socio-economic parameters and developments related to RMF customers. A majority of the population has a low income and wealth base, and on average spends 87% of the overall household budget on basic necessities. As a consequence, a setback can easily put a strain on a household's income situation: in the rural areas, two-thirds of all households are prone to be food insecure in case of external shock and yet the density of poverty is highest in urban areas. Main risks include flooding, pests, disease in crops, death or disease of livestock, death or disease of a breadwinner

[8] The data in the summary relate to the calendar year 2009.

and hospitalization of a household member. In urban areas, economic opportunities are best but risks are large for those who are not able to participate in the new, more market-oriented economy and lack an adequate backup network of family or peers. In cities people depend on bought food, on commercial housing and on job market which is highly competitive for those with low levels of education, which is the majority, while social security covers only few. Still, as opportunities to participate in a growing economy and to find good quality education are best in urban areas, some 700,000 people have moved there over the last decade and in effect have increased the urban population by 55% to 2 million people, or to 32% of the population. Over the same period the rural population stayed constant at 4.3 million. Opportunities to find work are also sought in neighboring Thailand, mainly by young, lowly educated Lao living in rural areas not too far away from the border. For households, migration of family members is a way to maximize income and diversify its sources. Between 260,000 and 400,000 Lao nationals work in Thailand, two-thirds of which informally and many on a seasonal basis, all of whom together remit an estimated $150 million to $250 million a year. In rural areas a main trend is commercialization of agriculture, posing added risks to subsistence level income and food production in exchange for commercial opportunities. Households with adequate buffer in income or wealth can reap the rewards without too much risk, yet vulnerable are those without. To succeed, skills are needed to plan, calculate, negotiate and understand the intricacies of contracts; skills which too many lack. Contract farming and the creation of agricultural enterprises and associations are growing in importance, and ways are sought to get a larger share of the total value added in production chains of agricultural products. Better quality warehouses are being built as part of the government's strategy to create food security and as part of commercial agricultural activities. As a consequence of natural disasters and partly related to commercialization of agriculture, food security is a challenge both at the level of individual households and nationwide. Another main challenge is found in demographics, as 50% of Laos' population is 19 years of age or younger. Over the next 10 years, 1.5 million young Lao people or 25% of its population will be looking to make an income and build a family, constituting an overarching need to create an environment that enables improved productivity and increased added value for the segment of Laos' society in which 85% of the population finds employment; the group of low-income and rural households operating informal, micro enterprises and undertaking a variety of productive activities in a self-employed setting.

Demand for RMF services; qualitative. The characteristics described lead to primary demand and latent need for financial services that help deal with risk; agricultural insurance specific for rural areas, social security more in urban areas, health and life insurance, savings opportunities to create a buffer and emergency loans. Savings and emergency borrowing are also sought to smooth income and expenditures. Money transfer service are sought to remit from Thailand and transfer from cities to the countryside. Savings are sought to build wealth and capital for investment and make use of productive opportunities. For the latter purpose, equity financing is not in much demand as micro enterprises lack formality yet credit is, predominantly in urban areas and rural areas with adequate infrastructure, and with better market access and economic opportunities as a consequence. Needs for financial services of low-income and rural households differ depending on the specific socio-economic situation of a household's location and individual household characteristics. Regarding loans, the certainty that a requested loan will be issued is the most sought characteristic, indicative of the importance of the overall relationship with a provider. Easy procedures, low-cost access, delivered by a provider with which a durable relation of mutual trust is able to develop, that understands a household-customer's situation and is flexible to it, delivers services which meet existing needs, and doesn't employ usury rates or reimbursement practices are what is sought for by low-income and rural households. Financial services are evaluated on the basis of overall costs and overall benefits versus available alternatives; interest is just one of the costs involved and for the lower-income households it is not the most important one.

Data, information and transparency. Publicly available data and information on the financial sector are lacking on demand and on supply, in both quantity and quality. Causes are multifold; they can be found in the lack of enforcement of existing legal obligations, such as the one for banks and formal MFIs to produce and publish annual reports, lack of rules obliging other financial institutions and financial sector government agencies to regularly produce and publish information on their financial status, the lack of reliable information contained in Lao Accounting Standards conform financial statements, combined with the high level of informality of the Lao economy and the apparent lack of priority given to transparency. The lack of transparency and information constitutes a main constraint, since a basis for well-informed policy and strategy development is found in good quality information. Inferences made in the current report in-hand are based on data and information in as far as available.

Demand for RMF services; quantitative: savings; loans; money transfers; remittances; private insurance and social insurance.

Savings. Total demand for savings in rural areas alone has been estimated to be $1 billion, about twice as large as demand for loans.[9] Savings in rural areas are traditionally done in kind, mainly in the form of livestock, and for about 20% in gold or cash. Lower-income and rural households are known to be able to save surprisingly large amounts and do so for good reasons, as saving forms a key strategy for low-income and rural households to deal with emergencies and income seasonality, and reduces the households' risk profiles. Savings opportunities are increasingly on offer predominantly in urban and semi-urban areas around the main economic centers of Vientiane, Savannakhet and Champassak. Main providers are banks and (a key group of stronger) village-based savings and loan funds (VSLFs), the latter largely operating outside the scope of the responsible financial sector authority, the Bank of Lao PDR (BOL). Regarding banks, the Agricultural Promotion Bank (APB) alone had 75,000 savings accounts with amounts less than $1,250 per account, while Phongsavanh Bank (PSB) said it has a total of 150,000 savings accounts with often lower amounts, here seen as a proxy indicator for RMF delivery. The key group of strong VSLFs serves 137,000 savers with an average of $140 per account.[10] In contrast, the Lao Postal Financial Institution (LPFI) has 17,000 savings accounts outstanding at $530 per account, while all MFIs that have been licensed to take deposits together managed

[9] Data of the year 2004 with exchange rate of today.

[10] In actuality, "savings" in VSLFs constitute risk-baring member capital; the reward is based on realized profit and funds are not easily or quickly able to be withdrawn. All VSLFs together manage over 300,000 "savings" accounts.

a mere 13,000 savings accounts. The number of people that save typically is two to three times the number of borrowers.

Loans. When assessing the market for loans, a similar picture emerges: outreach achieved mainly by banks and semi-formal village-managed loan funds (VMLFs), with lower outreach for formal MFIs. APB alone delivered $37 million in 9,000 group loans to some 80,000 families and 5,800 individual loans of less than $5,000 at an average of $2,670 per loan, in an overall portfolio of $52.5 million. The Nayoby or Policy Bank had at an estimated minimum of 55,000 loans outstanding in smaller amounts in an estimated total amount of $37 million. ACLEDA Bank Lao had 5,500 individual loans outstanding in amounts below $5,000 at an average of $2,600, a total of $14.3 million. All VMLFs together had 173,000 loans outstanding at an average of $250 making a total outstanding credit amount of $31 million, of which the group of core VSLFs delivered 43,000 loans at a $465 average. Again in contrast, all licensed MFIs together had delivered only 8,400 loans at an average of $469.

Money transfers inside Laos. Because of rural-to-urban migration there is demand to send money home to family members, mostly by young adults to their parents and siblings. APB provides a substantial amount of money transfers, 400,000 per year or about 1,500 per working day at an average of some $475 per transaction for an to people with or without an account at APB. The LPFI facilitated 234,000 money transfers over 2010, or over 900 per working day at an average of $40 per day on a cash-to-cash basis.

Remittances from Thailand to Laos. The between 250,000 and 400,000 people that work in Thailand hardly use banking services to remit, even when the few that do have (only) positive experiences. People bring money home, ask returning friends or relatives or use informal agents, the latter method with fees ranging between 3% and 8%. Risks of loss and delays are significant for all chosen informal manners. The main reason for Lao migrants to choose a particular method to remit is that it is the only way they know how to send money home. The value of remittances from Thailand to Laos constitute a large market for a financial service which is yet almost completely untapped by the formal sector.

Private insurance. Actual market demand for private insurance is virtually absent, despite a huge need to deal with risks within the Lao population and in particular within the group of lower-income and rural households. Existing providers merely service larger companies and a group of affluent individuals mainly consisting of car owners. Within a significant part of the group of stakeholders, including potential customers, financial sector professionals and government officials, there is an apparent lack of appreciation for the principles governing insurance and its functions. Improved awareness seems a prerequisite for any form of increased outreach, yet an explicit assessment of the causes for the current market situation is needed and should significantly include financial sector professionals.

Social insurance. As with private insurance, outreach and awareness are low yet the need to deal with risk is large. Currently about 12% of the population has been covered with insurance against healthcare expenditures. Social security has a benefit over private insurance that it is largely compulsory and has active support of both government and development organizations. There is however lack of compliance by companies, lack of power to enforce in the government and the objective of enterprises to stay informal; the latter because associating with the social security system triggers approach of the enterprises by the tax department. Health insurance copes with various issues, the primary one of which is how to regularly collect the many small premium payments, as outreach in low-cost, easy-to-use payment facilities to lower-income and rural households is lacking.

Recent experience and lessons learned. Significantly, regarding RMF sector development Laos has an adequate Policy Statement and an appropriately designated responsible authority; BOL. However, alternative definitions of RMF exist in other main policy documents as well as in practice, definitions which are at odds with the view embedded in the Policy Statement. Most widespread is the notion that RMF is the supply of small loans with low, subsidized interest rates targeted at the poor and poorest among the rural population, delivered through village-based revolving funds and through state-owned (policy) banks, the latter directed by BOL. Historically RMF in Laos has developed from food support in-kind with a tentative obligation to repay in the late 1980s, to small monetary loans with low, subsidized interest rates delivered to poor, agricultural households in order to provide food security and stimulate production. Traditionally RMF has been the terrain of mass organizations and ministries responsible for agriculture, social welfare and investment, at all levels, while later the formal financial sector was involved through policy banks directed by BOL, starting with APB in 1993 and later accompanied by Nayoby Bank in 2006. The traditionally held view of RMF has been embedded in the most important document on socio-economic development, the 6th National Socio-Economic Development Plan 2006-2010 and can be found reflected in data on outreach. The large majority of loans to the RMF segment are either provided by Nayoby Bank, by APB as part of their subsidized portfolio of microfinance group loans, or through VMLFs outside the group of core VSLFs, in the form of low-interest rate loans or on a non-cost recovery basis, by non-self-sufficient organizations supported by donors or the government, or in a combination of both.

Still, in the meantime significant improvements have taken place. Monetary savings were added as an RMF service starting through APB and later through VMLFs in 1997. The VSLF model then created, or at least a core group of VSLFs has been relatively successful in creating outreach in demand-oriented, low-cost RMF services under the condition of self sufficiency and has triggered bottom-up innovations in products, such as funeral insurance and in the structuring technical support through networks. These VSLFs have funding based on contributions by member villagers and have received long-term, adequate technical assistance aimed at creating independent semi-formal financial service providers; the two conditions known from experience in Laos and elsewhere to be positively influencing sustainability and success. Over the last years, in the broader group of VMLFs the focus has been shifting from the mere provision of low-interest loans to include savings opportunities and achieve sustainability. The emergency and development of the VMLFs, including VSLFs, has taken place largely outside the scope of BOL and microfinance regulations, as well outside the scope of the development community working on financial sector development.

Further growth in RMF provision in the form of money-transfer facilities happened through APB and since the year 2001 also through the LPFI, and social security in the year 2000. ADB assisted APB to restructure financially and organizationally, aimed at creating an autonomous, market-oriented rural financial institution. Starting 2004, the regulatory option of creating a formal MFI has been added, intended to allow the creation of independently owned and managed institutions with a well designed governance structure, supervised by a division of BOL specifically created for that purpose. So far formal MFIs have achieved limited outreach among low-income and rural households. As a consequence of the legal option of the creation of formal MFIs, a third definition of RMF seems to have appeared, in which a financial service is considered to be RMF only if it has been delivered by a formal MFI.

That it might take some time for the view embedded in the Policy Statements on RMF development (demand-oriented and holistic, aimed at institution building and self sufficiency) to be disseminated, understood and accepted, was foreseen by the Lao government's RMF committee. In an analysis made in 2003 to prepare the Policy Statement, the committee concluded that a weakness for RMF sector development is the fact that *"Some policy makers, local authorities and donors still lack a solid understanding of sustainable market-oriented RMF"*. This analysis was confirmed in two surveys held in 2007 under participants of broadly attended RMF stakeholder meetings including large numbers of government officials. The surveys concluded that *"The lack of understanding of the concept of building sustainable RMF delivery systems amongst a critical mass of key decision makers constitutes a main constraint"*.

RMF sector development and ADB's support to it was based on the issuance of the Policy Statement and implementation of a related matrix of reform measures, agreed between the government and ADB. Significant progress has been made, yet some key elements would benefit from full implementation and could have strong impact on outreach and quality of RMF delivery. Steps forward were made when BOL issued a notice allowing all banks to deliver microfinance loans backed up by group guarantee and when policy lending in APB was phased out as a first step to become a "market-oriented institution operating on best practice principles including institutional organization". Much more progress could be made if remaining elements of the Policy Statement would be implemented, in particular where the Policy Statement explicitly backs up RMF delivery by banks, where it warns that subsidized credit causes a threat as it undermines building sustainable and inclusive RMF systems and where it explains RMF providers require autonomy in their management, hiring procedures, setting of interest rates on deposits and credit services, access to capital, and in their choice of products, clientele and geographical areas etc.

To illustrate, a notice forbidding a spread between interest rates on loans and deposits of over 5% has been issued to the banking sector by BOL, disallowing cost recovery in the RMF segment. Some privately-owned commercial banks have been told by BOL officials not to deliver microfinance loans and APB has been observed not to be given full management authority, for example to design and price its own services to the RMF segment. Rather, APB has again been instructed to deliver microfinance group loans with interest rates at below cost recovery level, subsidized by the government. Issues mentioned constitute constraints to improved outreach and quality financial service delivery to lower-income and rural households, in particular since banks' added value to the RMF sector is large and has the potential to be much larger if allowed the full management autonomy mentioned in the Policy Statement.

Another main constraint identified in the same surveys just mentioned earlier has been a lack of coordination in the RMF sector. Looking at how over time the development of the RMF sector has taken place this can perhaps be better understood. BOL has been appointed the agency to manage the development of the RMF sector only very recently in 2007, while similarly only two years before that in 2005 a lower-ranked division had been made responsible to regulate and supervise only formal MFIs. Again two years before only in 2003 had the Policy Statement been issued. At that time already for over 15 years a broad spectrum of different government agencies, development organizations, practitioners and state-owned (policy) banks had been active as main issuers of regulations, designers of methodologies, builders of institutions and deliverers of the financial services, much of which through politically strong networks and larger than that of BOL.

Currently, due to the improved enabling environment many new financial service providers, mainly privately owned, have been established since about four years. Number, amount and complexity of involved financial services have increased and existing SOCBs have a more market-oriented approach. As a consequence, a strain has been put on BOL in its capacity as financial sector regulator and supervisor, aggravated by the multifunctional, ambiguous position BOL still has. Different roles and functions other than as financial sector regulator and supervisor are still assigned to BOL; roles and functions which originally were encompassed by BOL's historical predecessor, the State Bank and automatically passed on to BOL. Nowadays, BOL still has main functions as the arm of the executive part of the government and as de facto managing director of State-owned banks, and is engaged both in direct lending and in directing lending to fuel and steer the economy. These responsibilities undermine BOL's role as regulator, supervisor and coordinator and do not allow for maximum benefits of SOCBs' full market orientation and of a level playing field for all financial service providers. In the light of the recent market dynamics as a consequence of the improved enabling environment of the financial sector and of the economy as a whole, there are urgent needs to reconsider the appropriate roles and functions of BOL, and to strengthen BOL's capacity as financial sector regulator and supervisor.

In the many evaluation reports of its two main financial sector reforms programs over the last decade (the Banking Sector Reform program and the Rural Finance Sector Development program), ADB has observed that an improved governance structure between the SOCBs, LPFI and BOL, and stronger political support for or commitment to objectives agreed upon at the start of the programs, such as the ones laid down in the Policy Statement, constitute crucial necessary conditions for successful RMF sector development cooperation.

On the retail level, institutional capacity is in need of strengthening for formal providers such as APB, LPFI, but also Phongsavanh Bank and most formal MFIs. Yet institutions able to bring the necessary technical assistance inside Laos are lacking in quantity and quality.[11] Issues such as credit assessment, internal control, risk management, MIS, and product, human resource and strategic development need strengthening. ACLEDA Bank Lao can be seen as a positive exception. Foreign

[11] No further assessment of pawn shops has been made for the purpose of this report.

investment in MFIs is not allowed so import of systems, knowledge and experience is limited to development partnerships. Since recently, a significant number of donors organizations have engaged to support RMF sector development, but almost exclusively focused their support on provision by formal MFIs and BOL's Microfinance Institution division, both with little absorptive capacity and outreach. A small group of practitioners has been receiving ample training and funds, with progress lagging.

Next to BOL in its role as supervisor, the financial sector infrastructure over a broad spectrum needs strengthening. This process is partly already taking place, as both credit information bureau and interbank clearing are being been improved, and recently a memorandum of understanding has been signed between BOL and IFC to strengthen the payment system. Still, issues such as consumer protection, financial literacy, the capacity of the depositor protection system, standards on accounting and financial reporting, and the quality and quantity of the capacity of the accounting sector need improvement, in particular in the light of the strong growth of the financial sector, as the current level can best be described as basic.

CONCLUSIONS

Compared to the situation before the Rural Finance Sector Development Program a decade ago, significant progress has been made. Main results are the creation of a regulatory and supervisory framework for formal MFIs, and improvement in the institutional capacity and financial strength of the Agricultural Promotion Bank. The development of sustainable financial systems however, inclusive for low-income and rural households, and their micro enterprises, and delivering high-quality financial services that meet the demand of their intended customers can be seen as an ongoing process that has only just started.

From the many ADB evaluation and loan tranche release reports related to financial sector development programs including which the Rural Finance Sector Development Program (RFSDP), from assessments made at stakeholder meetings attended by a broad spectrum and a large number of participants, from various reports of assessments of the rural and microfinance sector and from interviews held, a coherent picture emerges which allows to make inferences as to what strategic steps could be considered to further strengthen RMF service delivery.

The main development issues that have been identified are located in what the ADB Microfinance Development Strategy (ADB 2000) describes as "policy environment". ADB's Microfinance Development Strategy considers the policy environment the first level of engagement in any reform program of a microfinance sector and it gives examples of issues considered to be part of that level; interest rate reforms, redefining the role of the state and the central banks to facilitate participation of private financial institutions, and non-financial policies such as agricultural pricing and taxation of micro enterprises.

The RFSDP based its engagement on mutual commitment by the government and ADB to what ADB's Microfinance Sector Development Strategy has identified as key issues to be dealt with in order to build a foundation for further development of a sustainable RMF sector, and which have been embedded in the Lao government's Policy Statement. From the perspective of Laos' RMF practice until the start of the RFSDP and with the benefit of hindsight, the proposed policy reforms can be considered a radical change. The RFSDP built its support in steps according to a sequenced matrix of reform measures, based on adoption of the Policy Statement by the government. The Policy Statement however was not fully in line with the main policy document on socio-economic development, the National Socio-Economic Development Plan and in other words has not yet been adequately embedded in the overall policy setting. Looking at the whole set of measures detailed in the matrix of policy measures as part of the RFSDP, parts of it have been well implemented and some important parts haven't yet.

Since ADB's Microfinance Development Strategy claims the need for commitment to adopting appropriate reforms for sustainable development as a prerequisite before support to other areas can be considered, such as the financial infrastructure and institutional development of retail providers, the conclusion has to logically be that solving the remaining issues regarding the "policy environment" should receive primary attention in the recommendations.

With important lessons learned during the implementation of the RFSDP on the side of both ADB and BOL, mutual understanding has improved. The time for constructive dialogue seems right, as recently four breakthrough steps have been adopted by the Lao People's Revolutionary Party and the government as leading principles for socio-economic development for the period from 2011-2015, and form a solid basis for the 7th NSEDP.[12]

[12] Source: HE Mr Somsavath Lengsavad, member of the Lao People's Revolutionary Party's Political Bureau, Standing Deputy Prime Minister and President of the Board of Directors of the Bank of Lao PDR speaking at LPRP's 9th National Congress in Vientiane, April 2011. Four breakthrough steps: 1. to relieve the minds of people from old stereotypes, complacency and extremism; 2. develop human resources; 3. address administrative procedures and management which impede commercial productivity rates and services; 4. address poverty.

KEY RECOMMENDATIONS

1. Create a committee in BOL functionally responsible for RMF development and directed by BOL's senior management. Issues concerning RMF development relate to various departments within BOL and often supersede the responsibilities of individual departments involved. As a consequence, there is a need for a functionally responsible organizational entity that oversees RMF development issues inside BOL and acts as a counterpart for other government agencies and international development organizations. Directly involving BOL senior management is warranted by RMF's importance for economic production and for employment, income and socio-economic well-being of over 80% of the population, and by the need for pro-active, intense coordination and cooperation with other powerful government agencies. The committee should include the directors of the departments directly involved, the bank supervision department and the financial institution supervision department and should operate under the direct responsibility of BOL's governor or a deputy-governor.

2. Build broadly-based understanding and consensus within the government on what is required to build inclusive, sustainable RMF delivery systems. ADB and BOL should openly discuss existing notions on RMF and what is needed for its development, with the explicit objective of finding mutual understanding, ownership and coherent political support. The best possible outcome would be a joint, holistic vision of building a demand-oriented and sustainable RMF system, inclusive for lower-income and rural households; a vision which has been embedded in the Policy Statement of the government and is congruent with ADB' Microfinance Development Strategy.[13] Key issues to address are found in the policy environment. They relate to interest rate reforms, redefining the role of the state and central bank, facilitating private sector participation and allowing management autonomy for RMF providers, as detailed in ADB's Microfinance Development Strategy.

2.1 Specific issues to propose and discuss should include:

- BOL being the Central Bank, should be allowed to focus on its responsibility as financial sector regulator and supervisor; BOL should be freed from its roles as

[13] Specifically, the understanding should include that; low-income and rural households' demands are what matter; that their financial service needs are aimed at objectives such as risk management, management of income and expenditures cycles, financial connectivity and exploiting economic opportunities; in terms of products, next to the need for loans for productive purposes there is a dominant need for savings opportunities, money transfer facilities including prominently remittances and emergency loans; that building an overall effective, efficient and sustainable financial system is what matters and various types of providers, banks, NBFIs such as the LPFI, pawn shops and in the future possibly mobile-phone service providers, formal MFIs, private and social insurance providers, and also semi-formal providers all have a role to play; that RMF providers require autonomy in their management, hiring procedures, setting of interest rates on deposits and credit services, access to capital, and in their choice of products, clientele and geographical areas etc. The understanding should significantly include the notion that targeted, subsidized, low-interest loans do not create value but lead to rent seeking and ineffective allocation, and undermine building sustainable institutions and a sound financial system with ample outreach. Value is created as a consequence of overall economic development, for which a well functioning financial system is a facilitator and necessary condition. A RMF sector inclusive for lower-income and rural households can help integrate these households in the overall social economy and thus help alleviate poverty.

direct lender to the economy, as actual manager of State-owned financial institutions and in general as a representative of the executive branch of the government. The governance situation between BOL and State-owned financial institutions should be made explicit, existing issues should be clarified and obstacles should be solved.

- RMF providers should be given full management authority, including SOCBs and the LPFI. In other words, RMF providers should be allowed to develop a strategy and implement it. BOL should issue a notice to all banks and the LPFI stipulating that they are allowed to engage in microfinance delivery and have the discretion to decide on interest rates. Notice No. 111/BOL of 28/04/2006, containing an interest-rate spread cap for commercial banks, should be withdrawn. BOL should issue a notice specifying the rules it follows to decide on approval of external borrowing from abroad by banks and financial institutions, including MFIs; these rules should be based on supervisory considerations only.
- The policy and practice of large scale distribution of targeted, subsidized low-interest rate loans as a panacea through the Agricultural Promotion Bank, the Policy Bank and village-managed loan funds should be phased out.

2.2 Non financial sector related issues crucial to RMF development to propose and discuss include:

- The Strategy and Prime Minister Decree on Small and Medium Enterprise Promotion and Development (SMEPDO) should be extended to include a separate, explicitly defined category of informal, household-based micro enterprises and should be renamed to reflect the change. Measures as part of the SMEPDO strategy, including significantly those on access to finance should focus on micro enterprises as they make up 93% of all enterprises and would thus be given the proper weight in the overall portfolio of policy measures.
- The regulatory setting for micro enterprises should allow for more benefits and less costs attached to formalization, which will stimulate the growth of micro enterprises into small enterprises and that way enhance productivity. Measures should focus on the reform of the current presumptive tax system and the introduction of simple accounting and administration standards.[14]

3. Explain, raise awareness and disseminate to find broad political support for the vision on RMF development embedded in the Policy Statement. For successful implementation the vision on RMF development needs to be understood, accepted and supported by a critical mass of high-level government officials, a process which should start at BOL. ADB could assist the organization of awareness-raising stakeholder workshops and exposure visits, and by supporting membership and participation in international networks of Central Banks and financial sector policy makers, such as the South East Asian Central Banks' Research and Training Centre, SEANZA and the Alliance for Financial Inclusion. For formulating RMF policy reform programs however, consultation with all major stakeholders, including

[14] Although liberalization of agricultural pricing and trade by rural households is a relevant issue for RMF development and has been explicitly mentioned in ADB's Microfinance Development Strategy, the current study in hand has not gathered ample relevant background information on the issue. Anecdotal evidence suggests constraints are posed to farmers as prices of paddy rice at the gate are determined by government notices and trade in agricultural produce, even within the borders of Laos, is constrained by red tape license requirements.

other government agencies than the financial sector authority, is a requirement found in ADB's Microfinance Development Strategy.[15] The vision on RMF development found in the Policy Statement should be explicitly embedded in the main policy documents, the 7th National Socio-Economic Development Plan, for which the an entrance is the formal series of Round Table Meetings, and in the Financial Institution Development Strategy 2009-2020. On issues for which true ownership, commitment and broader support are found, a detailed plan determining the course of action should be jointly designed by the government and ADB, for it to be agreed and signed by all as a basis for implementation.

If and when ADB considers adequate RMF policy reforms have been committed to, further recommendations are given below.

4. Provide long term, in-house, hands-on and on-the-job technical assistance to BOL in its roles as financial sector supervisor and as coordinator responsible for sustainable RMF development. Technical assistance should be jointly designed and agreed by the government and ADB based on true mutual commitment and ownership, and should focus on achieving specific strategic objectives related to supervision, information and transparency, coordination and consumer protection.

4.1 Supervision. BOL's management involved in financial sector supervision should be assisted to develop a strategy for supervision of overall RMF service provision by banks, various types of NBFIs and semi-formal providers. Supervisory activities and capacity have to be carefully prioritized and planned based on analyses and weighting of objectives of supervision, both prudential and non-prudential, risks posed by financial service providers and claims made on supervisory capacity. Technical staff involved in supervision should receive thorough explanation of the objectives of supervision, of the specific roles of each of the supervisory functions, and of the interrelation, and cooperation and coordination needed between supervisory functions; followed up by practical, on the job and task-oriented training concluded with a period during which back-up, helpdesk type of assistance is available.[16] A human resource development strategy should be developed with merit determining selection, evaluation and promotion of management and staff.

4.2 Data, information, transparency. Transparency and the provision of relevant industry information should be made a strategic priority. ADB should assist BOL, the Ministry of Finance and the Department of Statistics to assess information needs, organize data collection, structure provision of information and dissemination reports. There are various ways in which transparency and the provision of information can be enhanced:

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[15] In Laos consultations should at least include the Government Office, the Lao Women's Union, the Ministry of Agriculture and Forestry, the Ministry of Planning and Investment, and the Small and Medium Enterprise Promotion and Development Office of the Ministry of Industry and Commerce.

[16] The technical assistance to RMF supervision could well be based on the guidelines issued by the Basel Committee on Banking Supervision in "Microfinance activities and the Core Principles for Effective Banking Supervision", Augustus 2010.

- Regulatory obligations for financial service providers to provide information on their financial situation should be enforced and where lacking created.
- There should be regular collection of data detailing specifics and size of RMF demand. In line with the Law on Statistics, the surveys could be made part of census surveys by the Department of Statistics, initiated and steered by BOL.
- Overall industry information should be improved and should be provided on a regular basis. The Financial Sector Statistics and Annual Report issued by BOL should include a set of relevant financial sector indicators and qualitative description of the financial sector overall and the different sub sectors.
- Data, reports, policy and strategy documents relating to the financial sector should be actively disseminated and made available in soft copy via mailing lists, on the websites of the financial sector authorities or in a depository, in the latest version and in both the Lao and English language.
- There is a crucial need for improved standards on financial reporting by financial service providers and ultimately for adherence to International Financial Reporting Standards. Considering the time-lag involved in conversion, the arduity of the conversion process and its relevance in the light of the current rapid development of Laos' economy and financial sector, the time to start is sooner rather than later. The process needs specialized technical assistance and ADB should consider support.

4.3 Proactive coordination and cooperation with stakeholders: platforms of communication on thematic issues. ADB should assist BOL to proactively lead RMF development by initiating platforms of communication on thematic RMF related issues, for which those stakeholders are invited that are relevant to solving a particular issue. From the platforms, lessons could be learned by BOL on how to improve regulations, supervision and the enabling environment at large and for ADB on how to best support RMF development. Feasibility studies should be initiated if additional understanding is needed and the platforms should serve to share information, lessons learned and solutions found. If and when opportune, the platforms should proactively involve with existing structures such as the Bankers Association, the Microfinance Working Group, the Lao Business Forum and the Round Table Meetings. Significant issues for which communication is a priority include:

- Village savings and loan funds (VSLFs) and their network support organizations (NSOs): The focus of the platform should be on building mutual understanding, trust and cooperation between the semi-formal sector authorities and BOL. The objective should be to identify ways of including VSLFs in the formal sector and of linking VSLFs with the formal sector. This objective can only be achieved if the interests of VSLF stakeholders are accommodated and VSLFs benefit. Regarding NSOs, an assessment of the feasibility of financial intermediation of liquidity between member VSLFs and SCUs and of NSOs' role in delegated supervision should be made and, if feasible, should make suggestions for prudential regulatory requirements related to both roles.
- The need for and characteristics of the market for payment facilities with a focus on branchless banking, mobile phone based banking and the use of agent networks. The assessment should include cash-to-cash payments between urban and rural areas, payment of utility bills and payments as part of broader financial services such as (health) insurance premiums, savings, and of interest and principal as part of loan contract.

- The need and market for remittance services from Thailand to Laos.

4.4 Consumer protection and financial literacy. With outreach and complexity of financial service delivery increasing without a framework or institution of protection for consumers, ADB and the government should consider developing and institutionalizing consumer protection and introducing basic, rule-of-thumb type financial literacy education and training.

4.5 ADB and the government should consider to engage feasibility studies on the specific, relevant subjects of:

- Agricultural insurance: the subject should be assessed in the broader context of similar exercises done in Thailand and Viet Nam, and of ASEAN.[17]
- Warehouse-receipt financing.
- Any of the subjects discussed in workshops on themes mentioned immediately above where it turned out more information was needed.

4.6 Pilot "M-Money". ADB and BOL could consider cooperation in initiating a pilot with Lao Telecom to develop mobile-phone based payment services. The pilot should focus on work towards a prudential and non-prudential supervisory framework and towards control mechanisms for Lao Telecom to manage its internal processes and its network of agents.

5. Institutional capacity. In order to enhance the level of institutional capacity of RMF providers and RMF provision it is recommended to:

- Seek for long-term strategic partnerships for the Agricultural Promotion Bank and the Lao Postal Financial Institution. The partners should be established institutions that are successfully operating in the same specific market segment. The partnership should include a financial stake in the form of an ownership share, a position in the Board of Directors and ample influence in management decisions. Examples of actual opportunities of finding such partners exist in Rabobank Development (for APB) and the Universal Postal Union (for LPFI). If in the future the Lao Development Bank or Lao Telecom would be involved in RMF service delivery the same recommendation would apply to them.
- For MFIs, both those allowed to take deposits and those that aren't, it is recommended to allow for foreign investment by long-term, strategic investors with social objectives and track record of success in reaching large numbers of customers in a setting similar to that of Laos.
- For member-based RMF provision, integration of VSLFs into the formal sector (in the way just described in recommendation 4.3) is recommended as a first step. At the same time, the available institutional memory and technical assistance capacity found currently in existing non-profit associations and NSOs needs to be mobilized and integrated into the financial infrastructure. A market for those technical assistance providers needs to be enabled by embedding the reservation of budget by VSLFs for the purpose of buying technical assistance in guidelines issued by government and mass organizations.

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[17] ADB supported a study into the feasibility aspects of the development of agricultural insurance in Viet Nam in 2004 (TAR-VIE 38561).

- On the short term supply of training and technical assistance will remain supply driven and donor paid yet highly necessary. For this reason, ADB should consider to support NSOs and non-profit associations mentioned in the previous paragraph. ADB should consider supporting the training of large numbers of key staff of RMF providers and Lao meso-level service providers. If reputed institutions with local presence, knowledge and understanding would be engaged, such as CARD MRI and the ACLEDA-ASEAN Regional Microfinance Centre, supporting training could be a step-up to more permanent presence. The institutions could be induced to employ local staff, establish strategic partnerships with local providers, develop a curriculum with a local good-quality school and deliver resource persons as teachers or function as a breading place for local Lao spin-offs. For the long term, it is highly recommended to consider the support to the expansion of existing good-quality RMF training and technical assistance providers willing and able to provide services on a large scale.

Rural and Microfinance Sector Assessment
Lao People's Democratic Republic

I. INTRODUCTION

1. The sector assessment found below has been made as part of a set of activities under Component 2 of Asian Development Bank's (ADB) Technical Assistance (TA) 7500-LAO. Component 2, one of a total of three components, is set to deal with issues regarding the rural and microfinance sector (RMF) of the Lao People's Democratic Republic (Lao PDR).[18] The other components under the same TA have dealt with an assessment of the banking sector and banking sector supervision (Component 1), and with the issue of money laundering (Component 3).

2. The assessment has been set up to take stock of the current state of development of the financial sector of the Lao PDR, to serve as a basis for constructive dialogue between ADB and the Lao government, and to make recommendations for possible future ADB support. The TA is timed at a moment when two major projects to support the restructuring of the financial sector in the Lao PDR have almost been concluded. As a consequence, the assessment would normally show a new set of characteristics of the financial sector, reflecting the progress made under the two programs (ADB's Banking Sector Reform Program (BSRP) and Rural Finance Sector Development Program (RFSDP)) and could possibly identify new areas in need of support.

3. This assessment is the second report under Component 2. The inception period has been concluded with an inception report. In as far as it is relevant for understanding this current report in hand parts of the inception report will be repeated here.

4. ADB and the government prioritized the activities under Component 2 of TA following inception. They identified the need to prioritize given the recent launch of projects to assist the microfinance sector by GIZ and the United Nation Capital Development Fund (UNCDF), and given a recently done ADB study into the possible establishment of an APEX institution, which has been revised only in 2010. By prioritizing, the three donor institutions can complement activities among other things to maximize the effectiveness of the projects as a whole and of each of the projects individually.

5. ADB agreed with the government that TA 7500 will focus on sector assessment, and on designing and implementing study visits. Input into review of microfinance regulations was substantially reduced as this activity has been conducted by GIZ. It was further agreed that feasibility aspects of establishment of an APEX institution would be made part of the overall sector assessment and would focus on identifying relevant changes that might have occurred since the earlier ADB study.

[18] From here on, all references to a sector, an institution, a policy or a strategy document are made with regard to this sector, institution, policy or strategy document of the Lao PDR, unless indicated otherwise. Throughout the report, "Lao PDR" and "Laos" are used interchangeably to describe the country while "Lao" is used as adjective and adverb.

Finally, it was proposed and agreed that a stakeholder workshop will be organized around to disseminate the TA 7500 outputs.[19]

6. Input into review of the microfinance regulations is given below in chapter 2.8 "Microfinance institutions: regulatory and strategic issues" starting at page 73 in paragraphs 226-237, and in paragraphs 142-144, 171, 250-251 and 258. An assessment of the feasibility aspects of the establishment of a microfinance APEX institution is made in chapter 3.6 "APEX institution" starting at page 100 in paragraphs 312-318. Both chapters 2.8 and 3.6 can be found in this report's part C. "Assessment of Constraints and Development Issues".

7. The sector assessment has been based on desk research, interviews with available relevant stakeholders and knowledge gained during earlier surveys and studies in which the author has been involved. The latter only in as far as the knowledge thus acquired has lead to publicly available survey reports. Desk research has included relevant laws, decrees, regulations, policy and strategy documents, published reports of research and surveys done as well as statistics. Statistical information used has been based on official and most recent publications of the Department of Statistics (DOS) and the National Economic Research Institute (NERI), both part of the Ministry of Planning and Investment (MPI), and of the Central Bank, the Bank of the Lao PDR (BOL), as much as possible and in as far as available. For reference, a list of source documents and reports used can be found in Appendix 1 followed by a list of people interviewed in Appendix 2.

[19] Aid Memoire concluding the ADB inception mission fielded from 4-7 October 2010 for TA 7500, Component 2 and recording the mission's key findings and discussions during its stay in Vientiane.

II. SECTOR ASSESSMENT

A. Sector Assessment: Context

1. Outline

8. **Definition.** When assessing the RMF sector, the first question to answer is what defines it; what is or what should be the object of assessment? In the official Policy Statement of the government on the development of the RMF sector, RMF has been described as "the provision of a broad range of financial services, such as cash-based credit, deposits, insurance, etc., to the poor, low-income households and their micro enterprises (**microfinance**) and to people and enterprises in rural areas (**rural finance**)".[20] This definition is preceded by RMF's raison d'être, when the statement explains that "Access to basic financial services... is an important tool for people to be able to increase their income, build their businesses and manage shock throughout their lifecycle".

9. **Demand-driven.** The demand-driven approach to RMF embedded in the Policy Statement is even more distinctly clear where it stipulates that "the government is intended to promote the development of the RMF sector to increase outreach **so that** in the future people who currently do not have access to the banking system's services can satisfy their financial needs". In other words, ultimately the financial needs of low-income and rural households determine what RMF is or should be. [21] [22] The definition mentioned in the statement is practically identical to the ones used by ADB (ADB 2000) and the Consultative Group to Assist the Poor (CGAP).[23]

10. **Key concepts.** To complete the definition, the concepts "rural", "enterprise", "low-income" and "micro" mentioned in the Policy statement need to be considered. In order to enable a coherent analysis we will, in as much as possible, use definitions and classifications found elsewhere in reports, legal and policy documents of the government.

11. **Consistent use of concepts.** The consistency will leverage the use of data on the "rural" and "urban" societies collected and classified by DOS of MPI. For the concept "enterprise" this doesn't work well, as in different documents and statistical survey reports "enterprise" has been used to describe different concepts. For this reason we will give "enterprise" a broad meaning, to describe any form of

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[20] Policy Statement for the Development of a Sustainable Rural and Microfinance Sector", drafted by the ad hoc Inter Ministerial RMF Committee and BOL, endorsed by the government in 1760/PM, 17/12/2003.

[21] Added by the author

[22] Added by the author

[23] www.cgap.org. As only difference, one of form not substance, the latter two definitions explicitly mention money transfers as a financial service to be considered, whereas the Policy statement generally mentions a broad range of financial services and adds the words "et cetera" after giving examples of financial services in the form of credit, deposit and insurance.

organization of capital and labor, whether formal or informal, aimed to produce goods and/or services, and as such participates in economic transactions (outside the household) with the objective of generating income. The choice is made in order to stay close to the socio-economic reality in the Lao PDR and to include all potential productive activities.

12. **Low-income.** "Low-income" is a relative concept. In line with the relevant Prime Minister Decree on Poverty, "low-income" will refer to an income that is low relative to the expenditures that need to be made for basic necessities.[24] Yet, exact data on the extent to which incomes are "low", in this definition, in certain strata of the population or in certain areas are hard to get by. The definition of a "poor" household has been set at KN180,000 per head, per month for rural households and KN240,000 per head, per month for urban households.[25] Still, large regional differences exist in both incomes and prices of consumer goods as well as in the availability of basic necessities (food by means of own production, clean water, sanitation, electricity, health care). As the National Growth and Poverty Eradication Strategy already explained, "poverty is complex and can be viewed from many perspectives…. There are many ways to measure and assess poverty".[26]

13. **Micro.** Last but not least, we have to deal with the concept "micro". Interestingly, the word "micro" is derived from the Greek concept "microscopic" meaning "smaller than the scale of focus". An enterprise or financial service can only then be described as "micro" when it is out of focus due to scale, regardless of size in absolute sense. Put differently, the emphasis is on the focus as much as on scale. Indeed, a priori quantifying an absolute amount as ceiling for a financial service to be considered in this assessment is of little use in a demand-oriented analysis. The objective of developing a sustainable RMF sector is to bring "microscopic" households and their enterprises in the focus of quality-for-money, reliable and sustainable financial service providers, regardless of absolute size of an individual financial product, depending on the needs of the "microscopic" poor, low-income and rural households and their enterprises.[27] Indicatively, main RMF providers issue the bulk of their loans in amounts roughly between \$300 and \$3,000, depending on location, purpose, duration, number of borrowers etc. Still, not too much focus should be on absolute size; a group of 50 low-income farmers in a village that sets up an association or enterprise and need investment finance for a rice mill and storage facility in the amount of \$100,000 is in any case rural but in many ways also microfinance. In order to reduce poverty, an enterprise should leave the status of being "micro", grow and expand, include more low-income family members and staff, and in the process raise income.

[24] 10/PM, 25/06/2001. Rather than compared to an average or mean income in Laos, or compared to incomes per capita in other countries.

[25] Measured in 2011 by the National Leading Committee on Rural Development and Poverty Eradication in line with official National Poverty Line, the definition of which is embedded in the relevant Prime Minister Decree (285/PMO, 13/10/2009).

[26] NGEPS (2003), page 25.

[27] As stipulated in almost identical wording in the Policy statement; see page 2, paragraph 1 of this report.

2. Context

2.1 Economy, economic actors and population

Table 1: Country profile year 2009

Population:	6,127,910	Number of Households:	1,031,277
Pop. (15-64 yrs):	3,573,374	Number of Villages:	8,704
Area:	236,800 km^2	Number of Districts:	143
Density:	26 person/km^2	Number of Provinces:	16
Arable land:	4 %	Capital: Vientiane	

Source: Department of Statistics, Ministry of Planning and Investment

14. **Formal economy.** The financial sector is set in a formal economy which has been growing at high and steady pace over the last two decades when measured by increase of nominal Gross Domestic Product (GDP) per capita, with, on average, moderate or at least single-digit consumer price inflation, both interrupted only by the Asian Financial Crisis of 1997-1999. GDP growth per head has largely and increasingly been fueled by foreign direct investment (FDI) in natural resource based industries, such as hydropower and mining, and growth of the services sector. Official Development Assistance as a percentage of Gross National Income (GNI) has reached 9% in 2008, down from 22% a decade earlier.

15. **Employment in formal economy.** In the formal economy, as the developing industries are mostly highly capital and knowledge intensive, relatively few, mainly highly qualified, staff are needed. The low level of education of the general population often precludes hiring (large numbers of) staff of Lao nationality. Qualified, well educated Lao nationals that are on the job market have predominantly been hired by the development industry and to some extent by the government, within the latter often in non-decision making positions just below the management. The manufacturing industry and hospitality sector absorb less well-educated Lao workers in moderate yet increasing numbers.

16. **Informal economy.** As a consequence, despite impressive growth in GDP per head, the large majority of the population -some 6.1 million people, living together in 1.03 million households in 8,704 villages (MPI DOS 2010, data for the year 2009) - is still making a living in an informal, predominantly agriculturally based economy, largely outside official statistics or scope of the formal economy. As found in the most recent Economic Census (MPI DOS 2007), analyzing a broad base of "economic units", including both large and formal companies as well as small informal ones, the economic output of most of the identified total of 209,484 economic units will not be found in any GDP or GNI statistic.[28]

17. **Micro tax system.** Of all, 29% have not registered at all with the tax-authorities, while 50% pay lump sum tax. To clarify the latter; in the Lao PDR, a tax inspector and (small) business have the legal option to negotiate rather than measure

[28] Just in this respect alone they are already truly "microscopic".

taxable income and pay a lump sum tax amount.[29] It makes economic sense for a small business to negotiate a tax obligation if the result would be a lower tax liability than in case the tax liability would be determined by way of measuring income based on filed financial statements. Colluding with a willing tax inspector by paying him "under the table" can make both better off, as the tax inspector doesn't have to do any actual work and makes additional income on top of his (meager) official salary.[30] In the Lao PDR this has been observed to happen on a large scale.[31]

18. **Micro accounting system**. Further indications of informality can be found in the fact that 75% of all economic units do not practice any form of bookkeeping or accounting, only 40% had registered with the Ministry of Industry and Commerce (MIC) and only 3% make use of a computer.

19. **Micro enterprise size and scope.** Regarding scope and size, 99% of economic units operated from a single location, 99% produced only for the local (Lao) market, 97% were solely Lao owned and 93% had four or fewer people working in the unit (MPI DOS 2007).

20. **Micro enterprise activities**. Economic activity of the units is mainly concentrated in micro businesses that are engaged in some form of trade; the category "wholesale, retail trade and repair shops" makes up 64% of all economic units and absorbs 39% percent of all labor, with an average of 1.7 staff per unit. Interestingly, the Economic Census on which the analysis is based, has not included businesses without permanent location (tuk-tuk drivers, ambulant sellers, carpenters etc.), enterprises that were temporarily closed or that do not open full time and significantly also household (commercial) agricultural production "with only one labor such as handicraft, weaving, agriculture, forestry and animal breeding". As a consequence the actual importance of "micro enterprises" for economic production, income and employment is even higher than indicated (MPI DOS 2007, p. 5).

21. **Household enterprises.** The latter exclusion of some types of enterprises might also explain why another survey by the same DOS, the Lao Expenditure and Consumption Survey (LECS), identified a total of 280,000 household businesses, easily surpassing the identified number of units in the Economic Census, while the LECS did not even include large, non-household based companies (MPI DOS 2009). Indicative of the notion that the large majority of household businesses might indeed be small enough to be "microscopic" is the size of the number of people running them: in 64% not more than one household member is working, with 99% having a maximum of four household members and 93% having a maximum of one staff hired from outside the household.

22. **Economic value informal economy.** Indicative of the relevance of informal economic activity by households and micro enterprises in Laos, the total value of the informal economic activities or of the "shadow economy", has been estimated to be

[29] If **presumed** entrepreneurial revenue is less than KN400 million.

[30] Schneider (2006), ICA (2007)

[31] ICA (2007). Ample anecdotal evidence indicates that companies hold two, even up to three "books"; one real book for the owner/management of the company and one for the tax inspector, with sometimes even a extra book for the tax inspector that insists on seeing the real book; see also Martin Stuart-Fox, Asian Studies Review, volume 30, 2006.

33.4% of official GDP in 2002/03.[32] Extrapolating the percentage to the 2009 GDP would amount to a monetary value of a staggering $1.9 billion.[33] As informal economic activities have been observed to rise progressively with the growth of the formal economy, the actual value is currently expected to be higher.[34] Corroborating the progressive growth is the strong rise in the number of informal, household-based enterprises, which have increased almost 50% between 1998 and 2003.[35] For further perspective on the relevance of micro, household-based enterprises for employment and income see Table 2:

Table 2: Workforce and occupation

=> Economically **active: workforce**	**Total**	**Percentage of workforce**	**Percentage of category**	**Percentage of total population**
Total workforce	**3,392**			55 %
Self employed	- 2,876	**85 %**		47 %
-- own account worker			48 %	
-- unpaid family member			52 %	
Employees (salaried workers)	- 468	14 %		8 %
-- Government, semi-government employee & state enterprise employee			62 %	- 5 %
-- Private company employee			38 %	- 3 %
Unemployed	- 48	1 %		

Sources: Based on the Population Census (2005), Economic Census (2006), LECS IV (2007/2008) and the Statistical Yearbook (2009) all by DOS of MPI. As data of various reports have been combined, the true numbers might diverge slightly from the ones reported here.

23. **Rural population and agricultural production.** Most of social and economic life in the Lao PDR is concentrated in rural areas and on agricultural production. Currently 68% of the total population is living in rural areas and on average between 49% and 66% of labor force's working hours are spent on agricultural production earning 30.5% of measured GDP. Of the remaining working time available to the labor force between 20% and 15% is spent on other income generating activities.[36]

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[32] Schneider 2006

[33] Using the 2002/03 percentage, or in other words not extrapolating the observed proportionality of growth, at prices and the exchange rate of 2009.

[34] WB and ADB 2007 based on DOS of MPI: LECS II and LECS III.

[35] DOS of MPI: Lao Expenditure and Consumption Surveys numbers II and III (LECS II and III).

[36] Here outcomes differ between LECS IV (MPI DOS 2009) and the Economic Census (MPI DOS 2007), which perhaps can be partly explained by the different timing of the surveys. Differences in definitions however also contribute to lack of comparability. Still, the main trend in the outcomes of both surveys is the same.

2.2 Rural and urban socio-economic societies

24. **Three socio-economic societies.** Within Lao society, large differences can be observed if analyzing based on a coherent set of social-economic, demographic and geographic characteristics. The following description has been based on similar distinctions made in household surveys by the DOS of MPI, most recently on the Lao Economic and Consumption Survey number IV (LECS 4, MPI DOS 2009). Modeling, it is possible to distinguish three different types of "socio-economic societies", based on a set of characteristics related to their socio-economic activities, opportunities and risks, with consequential effect on demand for and adequate delivery of financial services.[37]

25. **Rural without road.** In those rural areas that lack accessible physical infrastructure (roads), coinciding with a lack of electricity and telecommunication facilities, low population density and a high percentage of ethnic minorities in the population, subsistence farming on privately owned or communal land, combined with hunting (fish, frogs, forest animals) and gathering (wild vegetables, roots, herbs) are the main sources of income. This type of society is geographically located mainly in mountainous areas with less fertile soil and is largely self-sufficient, even if it lacks access to some basic and vital services such as health care, electricity, potable water, sanitation etc. The area roughly coincides with those 47 districts that are considered the poorest, out of a total of 143 districts in the country.

In its present situation, the population living in these areas have very little chance of successfully becoming part of a larger market (economy) due to lack of physical access, high transaction costs (transportation, loss of time), lack of means of communication and related lack of information, and lack of necessary production factors (education, knowledge, capital goods, materials).[38] Disconnected from markets, there is little need for a medium of exchange or unit of account. Indeed, quite a significant part of the Lao economy operates largely without the need for money and lacks functioning markets, including food for money markets.[39] Savings is done mainly in kind (livestock) with maybe 20% of savings made up of gold and cash money. Insurance against some main risks (e.g. death of a breadwinner) and "financing" of needed productive input (work on field) are organized by building strong reciprocal intra-communal relations and marriage. Because of low level of leverage in income and capital combined with the need to deal with socio-economic shock (death or hospitalization of a breadwinner, natural disasters, pests, death of livestock), because of fluctuating and non-synchronous income and expenditures streams inherent in agriculture, combined with the lack of opportunity to diversify income streams and risk as a consequence of being tied to a certain location, there is a huge need for means of dealing with socio-economic shock and managing income and expenditure streams.

[37] The analysis is based on similar distinction made in LECS 4 (MPI DOS 2009).

[38] Connections through river systems for some villages to a certain extent also provide available transport facilities, in particular when roads are inaccessible, opening up trade.

[39] See also ASEAN (2010), page 10, which describes a poor community of a "rural without-road area" that was part of a poverty reduction cash-for-work program, demanding food rather than cash because of lacking accessible markets for food.

26. **Rural with road.** The better the infrastructure available and the closer to a market rural households are living, coinciding with higher population density, geographical closeness to or location in Mekong's river system's low land with more fertile soil, the more opportunities arise to engage in additional productive activities next to subsistence farming, including growing commercial or "cash crops", and in the process diversify sources of income. Indeed, many rural Lao households sell agricultural products on markets or house-to-house, have small shops, trade or do manual work as construction worker when the seasonality of farming work allows for it. The labor productivity of these additional activities, in monetary terms, is large, larger than that of agricultural activities, as is the contribution of the extra income of these additional activities as a percentage of total household income. Because of increased market activities and trading, money becomes important as means of exchange and unit of account. As a consequence of the increased connection to the market economy the income and expenditures within this type of society are more depended upon price volatility in (international) markets, mainly the prices of their agricultural output, of food items and fuel. Another vulnerability found in this part of society is the one concerning decisions of the governments of Laos and surrounding countries that impact trade opportunities, such as price controls and import or export bans and tariffs. The economic opportunities in this stratum may be larger, still many characteristics found for "rural without-road" areas also apply for "rural with-road" areas. For a rural society with a predominantly agriculturally based economy, the risks created by natural circumstances (extreme weather, flooding, pests, etc.) remain significant.

27. **Urban.** In the four urban areas of Vientiane (stretching from Vientiane Capital into Vientiane Province), Savannakhet, Pakse and Luang Phrabang, market opportunities are best. As a consequence of the availability of necessary inputs for entrepreneurial activities, demand, low transaction costs, the availability of (relatively) low-cost good-quality market information and better physical market access, it pays to create an actual (family) business.[40] As mentioned earlier, labor productivity of additional economic activities such as trade is higher than that of agriculture. For a household in an urban area, if the opportunity is there, freeing up time for entrepreneurial activities will maximize total income and is hence appealing; in particular for those households which have secured enough food through farming or have enough leverage in monetary income.[41] As economic opportunities are best in urban areas most enterprises, 46% of all, have been established there while another 42% of all enterprises are located in "rural with-road" areas in the provinces containing the four cities.

However, life in the urban areas has also added a different type of risk. As on average people in urban society typically can rely less on the proceeds of family or communal land for food or the family house for living, they become more vulnerable for price fluctuations as a consequence of (international) market dynamics beyond their control.[42] With rising food and fuel prices in international commodity markets and

[40] Created by a large number of people and other businesses as customers, workers or suppliers in a relatively confined area.

[41] Or in other words, the downside risk of depending on having to buy food and being vulnerable for fluctuating and rising prices of basic necessities for those households is low.

[42] People in urban areas spend more than four respectively 2.6 times the amount of money on food than people in "rural without-road" respectively "rural with-road" areas. For housing (rent, utilities) the ratios are 4.3 and 2.8, for transport and communication 3.6 and 1.5.

increasing linkage of Lao and international markets, prices for basic necessities such as food have risen sharply on local urban markets in Laos. Moreover, again in particular in the urban areas in the Lao PDR, as a consequence of Lao's growing economy and the influx of huge amounts of money in the form of Foreign Direct Investments (FDI) and Official Development Assistance, prices of land and real estate have risen to very high levels if compared to less than a decade ago and consequently so has house rent. With necessary budgets for basic items such as food, housing and transportation and communication already making up 67% of total average expenditures, rising prices for food and fuel, combined with rising house rents can easily bring people doing unschooled work in for example the manufacturing industry on the verge of economic existence, when, for example, the export of clothes is under pressure because of the rising external value of the kip (KN) and an international economic downturn.

Table 3: Key characteristics of three types of Lao society

Characteristic	**Urban**	**Rural with road**	**Rural without road**
Avg. distance to nearest road, km	0	5	18
Reachable in dry season, %	100	100	83
Reachable in rainy season, %	98	80	17
Access to electricity, %	99	53	26
Receiving agricultural technical support, %	64	60	29
Avg. distance to Post office, km	8	22	40
Safe water in village, %	88	61	23
Access to toilet, %	89	59	34
Pharmacy in village,%	60	19	3
Within 10 km from hospital, %	75	20	11
Population	1,777,000	3,738,000	613,000
Characteristic	**Urban**	**Rural with road**	**Rural without road**
Workforce, active as, %			
Paid employee	27	9	7
Nonfarm household business	35	15	11
Self-operated farm	38	76	82
Food expenditure as % of total expenditure	39	50	61
Self-produced food as % of total food	22	65	76

Source: LECS no. 4 concerning 2007/2008 and Statistical Yearbook 2009, Department of Statistics, MPI.

2.3 Socio-economic trends and challenges

28. **Main trends: migration and commercialization.** Currently, two main trends can be observed that are relevant for the large majority of Laos' population which constitutes RMF's target clients. One is the strongly growing urbanization and migration, the second is the increased commercialization of agricultural production, both results of the reorientation of Laos' economy away from a situation of subsistence to a situation of economic growth.

29. **Main challenges: food security and demographics.** The intended turnaround of the socio-economic organization of Laos from a subsistence-agricultural based society to an economic-growth oriented society has created imbalances in food-supply. A second main challenge is found in the strongly skewed demographic buildup of the population, as 50% of all Lao people are 19 years of age or younger.

2.3.1 Urbanization and labor migration to Thailand

30. **Urbanization in Laos.** Over the decade ending 2009, the urban population as part of total population in the Lao PDR has increased from 21% to 32%; during the same decade the total number of people in the rural areas has remained a constant 4.3 million.[43] In other words, 700,000 people have joined the four main urban areas in Laos over the last 10 years, predominantly in and around Vientiane Capital, creating a total urban population of 2 million people, up from 1.3 million a decade earlier; an increase of over 50%.

31. **Labor migration to Thailand.** Next to migration inside Laos, a large and increasing number of mainly young, lowly educated Lao people from the rural areas have started working abroad, predominantly in neighboring Thailand. Although reliable data statistics are hard to get by due to the large extent to which migration takes place informally, an increasing number of surveys and some key statistics help to clarify.[44] In February 2011, a number of 93,429 Lao nationals had received both a temporary passport and permission to legally work in Thailand while an additional number of 11,194 had their work permits renewed, making a total number of 104,623 Lao nationals working in Thailand in accordance with legal requirements.[45] At the same time, formal procedures had not yet been completed for 58% of all eligible migrant applicants, while many hadn't even entered the process.[46] That the real number of migrants is much larger than the official one has been confirmed in numerous studies (Deelen 2010, Sisenglath 2009, IOM 2008 and Chanthavysouk 2006). The percentage of informal migration found in studies ranges between 74% and 60%. Applying these percentages to the number of Lao nationals that have

[43] Source: World Bank Data catalog. The statistics differ slightly from those of DOS of MPI when looking at absolute numbers; the trend however in both datasets is the same.

[44] Most of them from rural with-road areas not relatively close to the border.

[45] "Migrant Information Note no. 10 of April 2011", the International Organization for Migration.

[46] The so-called National Verification process has been created by the Thai government to get a better grip on migrants from three surrounding countries; Cambodia, Myanmar and the Lao PDR. For Laos the procedure has been created in 2006.

received official permission makes an estimate of between 260,000 and 400,000 Lao national working in Thailand alone.[47] [48]

32. **Causes for migration.** The causes for migration, whether to urban areas in Laos or to Thailand, are the same and the resulting type of migration can best be described as "labor migration" (IMO 2008, Chanthavysouk 2006). For young, rural Lao, there are few employment opportunities, the available work (agriculture) is tough, educational and medical facilities are lacking, and generally life is tedious with little prospect of improvement. Life in the city holds the promise of better education, better possibilities to earn money and support the family (parents and siblings) and the excitement of what seems to be an interesting and modern lifestyle, filled with opportunities to buy new beautiful glittery goods as witnessed on television and rumored by peers. An increasing number of young, rural Lao feel the desire to be part of that life. Many leave not well informed or prepared, but a growing number of migrants benefit from existing networks of Lao people already working in Thailand.

33. **Consequences of rural-urban migration inside Laos.** The current level of migration to urban areas in Laos has the upward potential of better education, better jobs and higher income for the young migrant. For the household to which he is connected, a diversified source of (potentially) high monetary income has been added. For the ones that succeed, sending money to their family back in their hometown in the province is a main objective and for many a reality; to illustrate, the Lao Postal Service Financial Institution (LPFI) alone reported over 250,000 money transfers in the Lao PDR over the year 2010 or almost 1,000 per working day.

34. **Rural-urban migrants' risks.** At the same time, rural-urban migration comes at a risk for the migrant.[49] As many of the migrant are young and lowly educated, their incomes, even if higher nominally than in their former hometown, will not necessarily be higher in real terms, as prices for daily expenditures such as housing and food are significantly higher in urban areas. An increasing number of companies from countries such as Japan, China, Viet Nam and South Korea are investing in Laos setting up factories, or planning to do so, because of low minimum wage, ample available inexpensive labor, political and social stability and available electricity supply. As a consequence, income by young formerly rural migrants will increasingly be earned in lowly paid salaried jobs in factories, construction and services (restaurants, tourism), the availability and success of which depends on external factors determined by the business cycles of the world economy. Currently construction of buildings and urban development efforts cater first and foremost to the affluent, such as people working for foreign companies and development

[47] That these numbers are quite accurate is further indicated in Deelen (2010) quoting a spokesman of the Lao Ministry of Labour and Social Welfare who estimated the total number to be at 300,000 of which some 30% have registered. In 2004 a number of 181,614 Lao nationals registered with the Thai authorities requesting a work permit, 105,259 of which subsequently received one that year.

[48] Another 322,599 Lao nationals have been measured to live outside of the Lao PDR in other countries than Thailand, with the large majority in developed countries, most noticeably the USA. (206,722), France (43,636), Canada (14,376), Australia and New Zealand (10,582) and Germany (10,639).

[49] Also: "Rural/Urban Inequalities and their implications in Laos", Ben Archer, St. John college, Darwin Australia.

organizations, while housing for migrants depends on family and friends, or is provided by the factory or in the form of sharing small rooms with meager facilities, still absorbing a large chunk of available budget. While rice and basic food items are available for all, the safety that was brought by the availability of food produced or gathered by the family is gone. Sickness, an operation, an accident, pregnancy, an ineffective labor market or loosing a job all have the potential of putting the socio-economic wellbeing of the migrants at risk, as a well functioning social-security network with outreach and protection of workers rights are both lacking.[50]

35. **Urban poverty.** Indeed, detailed analysis of factors related to poverty based on household census data of the year 2005 (before prices for food and fuel started their spectacular rise on international markets and before much of present day rural to urban migration had take place) already showed that in the Lao PDR density of poverty is highest in urban areas (Epprecht 2008).[51] Moreover, next to the social-economic well-being of young rural-urban migrants themselves, a large and increasing number of aging Lao people in the rural areas side directly depend on the success of the endeavors of their offspring in the cities of Laos and Thailand.[52]

36. **Consequences of migration to Thailand.** Migration to Thailand has the benefits for migrants of finding large demand for unskilled labor, higher wages and low unemployment. Young Lao nationals, mostly members of relatively poorer families living in the rural areas geographically located in or close to the flatlands near Mekong and close to the Lao border with Thailand, seek economic opportunities elsewhere.[53] As most of them are lowly educated, mainly manual work is found in factories, construction or in the services industry (assistance in households, restaurants etc.). Similarities in culture and language as well as the often existing family bonds or peer networks facilitate migration to Thailand. Just like the reward for labor in household and micro enterprises within Laos, much of the contribution of the international migrants will not be found in GDP or GNI statistics.[54] Again, it's estimated value and contribution to income of rural and low-income households in Laos is large. Estimates based on available surveys range between $150 million and $300 million per year from Thailand alone, which compares for example to the contribution of the garment industry to GDP.[55] [56] Interestingly, in an analysis based on academic research using actual census data, the estimate of the total value of

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[50] Indicative for this situation is the recent (June 2011) request made by the Lao Federation of Trade Unions to double the legal minimum wage to protect workers and (again in June 2011) by the Cultural and Social Affairs Committee of the newly installed National Assembly to extend the outreach of the social security system.

[51] Both the absolute number of poor people and the density of the poor population.

[52] The latter we will see in the paragraph immediately below.

[53] Mostly from "rural with-with road"

[54] GDP only measures production within the geographical area of the Lao PDR. Depending on the GNI definition used, the reward for labor of Lao nationals abroad would count. However, most of remittances are done informally, as we will see later in the paper, or in other words are not officially counted.

[55] Using the various values for relevant variables found in a multitude of surveys; median and mean amount send home per year, percentage of migrants remitting and number of migrants.

[56] Which was $159 million in 2009

international remittances to Laos from countries around the world has been found to be some $1,175 million or around 34.5% of GDP in the year of measurement.[57]

2.3.2 Commercialization agriculture

37. **Commercialization of agricultural production.** Based on policies of the government and supported by development organizations, agricultural production in Laos is increasingly organized with a commercial orientation, away from the traditional household-based, subsistence setting. Foreign investment in agriculture is being stimulated by granting licenses and fiscal benefits, often going hand-in-hand with organization of production on a larger scale. New technologies are introduced to increase output and agricultural products are introduced or grown on larger scale for its monetary value in export. With this development new economic opportunities and risks arise.

38. **Farmers' risks from commercialization**. Improvement of production methodologies and introduction of new products have the potential to generate extra income but come at an opportunity cost. Without the in advance expected revenue, invested labor and finance, and forgone crops are lost. As some technologies and products are new to Laos and farmers lack knowledge and experience, and as information or plans of commercial partners sometimes do not materialize, revenue can be disappointing. Even if production is as expected, revenue is subject to market dynamics, payment and finance modalities, and depends on the reliability of commercial partners and decisions of governments. Many of these are new phenomena to rural households. Indicative, "pig cycles" have been observed and prizes of produce vary with the seasonality of harvesting.[58] Still, even if production is adequate and there is no immediate food shortage or other major setback, the lack of good-quality storage facilities and distribution channels undermines a strong position to negotiate in the selling process. If storage is available, there is the cost of capital for the goods stored at best, possibly aggravated by damage to or loss of stored produce in case of lesser quality storage. More examples are given below.

39. **Food shortage due to commercialization**. With more affluent neighbor farmers now selling and exporting even the main staple, rice, at commercial prices, both on micro level (for an individual farmer whose commercialized farming didn't work out and doesn't have enough buffer) and on macro level (parts of the country have rice shortages while others export) commercialized farming can have negative side effects and even create food shortages.[59] In order to deal with these effects and create a buffer, the government has developed the strategy of building storage

[57] IFAD 2006; interestingly, the official number of Lao nationals in Thailand used for to base the estimation on was 29,137, which currently, as we have seen, is a huge underestimate.

[58] Pig cycle refers to an economic phenomenon of cyclical fluctuations of supply of an economic good (e.g. pigs; the phenomenon had initially been observed in markets for livestock and if often found in lowly developed markets for agricultural products) and its related market price, due to time lags created by the duration of the production process. The consequence are irregular, uncertain production and supply of food items, fluctuating prices for consumers for basic food items and an uncertain market environment with fluctuating income for farmers.

[59] Currently the government is issuing various measures to mitigate the consequences, such as price controls and the building of storage facilities.

facilities and uses price control measures, for example of the price at the gate of paddy rice.

40. **Risk factors.** For individual farmers, risks are larger if they only produce a single crop, or work exclusively within a contract farming arrangement or as a wage laborer on company land. At the same time, as agricultural produce and in effect the land on which it is being produced is being given a commercial value or price, previously existing strategies used by subsistence farmers to cope become at stake as communal land and forests are increasingly (legally and illegally) being taken to use for commercial production and are no longer available ("for free").

41. **Two main approaches to agricultural commercialization**. Much of current day commercialization of agriculture in Laos is done along the lines of one of two ways, best summarized as "contract farming" and (interventions based on the) "value-chain approach". As part of those approaches, in particular the latter, formation of agricultural enterprises and associations is often used.

42. **Contract farming.** Contract farming is much used in a commercial setting in which companies or traders, either from within Laos (e.g. Beer Lao for rice, Kolao Group for jathropha) or from neighboring countries (e.g. Thai traders or Thai companies buying corn as animal fodder, Chinese companies setting up rubber plantations), approach farmers (mostly on an individual basis) to negotiate buying the farmers output on a pre-agreed set of conditions regarding buyers input, the farmers input, respective risks and responsibilities, and, importantly, price. Finance and interest rate remain implicit or are made explicit, yet are part of the arrangement. As analyzed (Setboonsarng 2008) contract farming is spreading rapidly in Laos and has the potential of being an effective tool for increasing the incomes of low income farmers, in particular there were physical infrastructure has just been established. Still, as most contract farming contracts in Laos are informal arrangements and, even if formalized contracts would have been made, legal recourse is tedious, risks exist on either side of the contract, including also significantly for the low-income, lowly educated farmer. For the latter, not experienced in the market dynamics and legal repercussions of commercial arrangements in the first place, contract farming can be a risky arrangement.

43. **Contract farming risks.** In case of produce for export, suddenly imposed import (e.g. by Thailand's or China's governments) or export (by Laos' government) restrictions, tariffs and price control measures have left farmers with unsellable produce (e.g. fodder maize to Thailand) or disappointing revenue. Disappointing produce as a consequence of lack of familiarity by farmers with newly adopted crops (e.g. rubber, jathropha) or lack of adequate support by the commercial enterprise (e.g. jathropha by Kolao) have also shown to pose a serious risk. Those farmers who have leverage in income, possessions (livestock), estate (land) or have enough food by means of own production can engage in a commercial enterprise (sometimes even adventure, as in the case of some exotic products) without a huge downside risk. If successful, they are increasingly able to rely on bought, rather than self produced food. Many rural households however, are not in that position. A setback literally puts their existence at risk or can leave them in debt, or loosing land or house, which is often is demanded to put in as collateral by traders during "contract farming"

arrangements.[60] For comparison, farmers under pressure because of a setback and lack of means are known to sell their rice while it is still growing at sometimes steep price discounts or put differently, at huge interest rate. "Contract farming" at its worse can be like that.[61]

44. **Value chain approach.** Another strategy now rapidly growing in importance in Laos in support of farmers is that of trying to add more value than just that of producing of "raw material". An analysis of the total (monetary) value created in a chain that leads from (the producer of) the basic material to (the sale of the end product to) the end consumer forms the basis of this approach, followed by an analysis of the possibilities for farmers to enhance their contribution to the total added value and so earn a larger part of the total reward. Hand-in-hand with this approach, farmers, assisted by development organizations and the government, set up associations and enterprises to effectively pool resources, strengthen their market position and create economies of scope and scale. This preposition builds on strengthening the farmers and farmers' organizations economic position. Often, new machinery, organizational, marketing and/or sales technologies are part of the intervention for which finance arrangements are often crucial.

2.3.3 Food security and demographics

45. **Two main challenges.** There are two major challenges for Laos socio-economic society directly related to the subject of RMF and its intended customers.

46. **Food security.** The first major challenge concerning low-income and rural households is food security, or broader, the security of basic necessities. During the recent dynamics of rising food and commodity prices on international markets, including importantly the price of fuel, combined with the increased commercialization of agriculture for the purpose of export, the monetary value of import of food has seen a 40% increase just over the first 6 months of the fiscal year (October 2010-March 2011). The import value of fuel and gas, relevant as significant input for all types of production, including food production, and normal functioning of contemporary society, has risen by a staggering 80% over the same period. Overall, a trade deficit has developed of $174 million. This development is ultimately unsustainable and if continued will lead to increasing problems with securing food and basic necessities, in particular to Laos' low-income and rural households. As food production is mainly taken place in rural, often also low-income, households, the contribution of this stratum of society to the necessary increase in food production is crucial.

47. **Demography**. Laos has a strongly skewed demographic composition of its population; no less than 50% of the population is under 20 years of age. Over the next 10 years, 25% of the population will enter the labor force, want to build a family and earn a living. If current trends continue, most of them will seek a better future in

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[60] In a recent online discussion under the heading "Land grabbing under contract farming" amongst consultants, staff of development organisations and government officials, all members of a Google group called LaoFAB, a flurry of stories indicated the existence of potentially large scale problem.

[61] Selling green rice or "chai khao kiaw".

either an urban area in Laos or in neighboring Thailand. As actual employment is currently overwhelmingly found in a family or household setting, containing a large agricultural component combined with a portfolio of income generating activities (more rural), and in actual micro enterprises (more urban), economic growth originating in micro, household-based enterprises of the typical RMF clientele is of utmost importance for the future capacity of Laos to absorb the demand for labor of its under 20 year olds and their aspirations to build a family life with at least enough food, housing, health care and education.

B. The Sector: Demand and Supply

1. Demand

1.1 Background and outline

48. **Demand's central importance.** This chapter deals with the fundamental, yet too often neglected question, what the characteristics and size of actual demand for RMF services are. The question consists of two parts, one of definition and one of measurement. In Laos, like in the rest of the world, discussions on microfinance have often foregone the first part and assumed the second part to be insatiable. Debates on policies and actual RMF project design were held without agreeing on what the topic was or should be. As each of the various participants in the debate had their own definition of RMF and as this definition and related assumptions remained implicit and untested, misunderstandings were plentiful.[62]

49. **Microfinance=microcredit=magic?** Most often and still today microfinance is seen by many to be synonymous with credit. Not just any credit, but microcredit, hailed as a tool par excellence to eradicate poverty. Just the supply of a very small loan would raise peoples' income enough to leave the group of poor in a process the workings of which remained obscure. Informally proclaimed global Millennium Development Goal (MDG) ambassador and rock star "Bono" of the world famous rock band U2 went as far as to the state that "giving a fish to a man would feed him for a day, but giving microcredit to a woman would feed her and her whole extended family for a lifetime", bestowing microcredit with powers of biblical proportion.[63] Fast forward to 2011 and microfinance in the form of credit has been criticized in international media and a global academic debate on its added value has been unleashed. In the global media, the subject of microfinance has been debated over the heads of the people concerned, the low-income people, who during the whole process of hyping and de-hyping have remained "microscopic"; outside the scope of those writing about them.

50. **Macro misunderstanding about microfinance in Laos.** Although a debate hasn't taken place in Laos in the way and to the extent that it has in RMF academic circles and in international media, the implicit assumptions and misunderstandings about what microfinance is, or should be, are the same. Next to the official, explicit definition found in the RMF Policy Statement, microfinance in Laos has been seen to be synonymous with "directed, low interest loans below $500 to the poor in rural areas" both in the design of many projects proposed by international development organizations, and in guidelines, policy and legal documents of the government and mass organizations, as in daily practice.[64] Another understanding often found, is that microfinance is that what is done by microfinance institutions licensed or registered

[62] Including the many different parts of the international development banks, (international) non-government organizations, trainers, practitioners, government, mass organizations, and consultants.
[63] Paul David Hewson or "Bono", Irish singer and musician, and main vocalist of the Dublin-based iconic rock band U2.
[64] E.g. 6th National Socio-Economic Development Plan, Prime Minister Decrees on Resettlement and Compensation in development plans, project design of large ADB rural development and agricultural projects, et cetera.

by BOL[65]. Again some see RMF as the services provided by VMLFs, the latter working outside the scope of BOL.[66] [67] Interestingly, the latter three definitions may well represent the understanding of the largest number of policy and decision makers, and of development workers, rather than the official definition found in the Policy Statement and in ADB's Microfinance Development Strategy.[68]

51. **Lack of understanding is main constraint.** As a consequence, a main finding of RMF sector assessments and microfinance sector stakeholder meetings has been that the lack of solid understanding of key principles and concepts related to demand oriented, sustainable RMF by (too many parts of) international development organizations and key decision makers in the government constitutes a main constraint for sustainable RMF development.[69] The second main constraint often found is the lack of dissemination of these principles and concepts, which have been embedded in the Policy Statement and are based on lessons learned and solutions found elsewhere in the world, combined with the documentation and dissemination of lessons learned specifically to Laos.

52. **Introduction of the microfinance demand analysis.** Having defined the intended customers and the characteristics of their socio-economic setting including its main trends and challenges, the attempt immediately below will be to detail what low-income and rural households demand or could benefit from in terms of financial services. We will use the main contribution of the polemics in academic circles and media, the demystification of "microfinance" and a refocus on the central question (what do poor and low-income households actually really want or could benefit from in terms of financial services?) and attempt to identify demand for microfinance in the Lao PDR as defined by the official RMF Policy Statement: Is it possible to characterize and quantify demand or at least indicate directions in which to look?

53. **Target group not static or clear-cut.** When analyzing "demand" it should be realized that RMF's intended group of customers is neither clear-cut nor static. For example, measuring exactly whether or not a household is just "low-income" or "destitute poor" (the latter said to be better of with social programs, such as cash or in-kind transfers rather than MF) is tedious while continuous economy broad (e.g. price increases for food in international commodities markets), local (e.g. flooding) and idiosyncratic (e.g. death or hospitalization of a breadwinner, a bad harvest) incidences can move households down the scale measuring income and wealth into the group of low-income households or even into the group of destitute poor. And noticeably, households can move themselves out of the group of low-income households if successful in their economic endeavors.

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[65] An understanding found with Lao practitioners working in those formal MFIs, by (departments of) international development organizations working on financial sector development and within BOL.

[66] This understanding is mainly found in the parts of the Government working on agricultural or rural development (MAF, NAFES), on poverty reduction (PRF) and in mass organizations (LFNC, LWU), as well as in the (departments of) international developments working on agricultural or rural development.

[67] As one Lao microfinance expert explained it to us: "There is Lao Women's Union microfinance and there is Bank of Laos microfinance".

[68] And CGAP for that matter

[69] Stakeholder meetings: UNCDF-AFIP project, National Microfinance Forums organized by NERI, RMF Policy Statement and Action Plan

54. **Different RMF subgroups with different RMF needs.** Important to note is also that different groups of (potential) customers have, at least partly, different needs for financial services; a trader on a market in the city center of Vientiane has different (financial services) needs, receiving and making many small payments in a single day, than a paddy-rice farmer in the poor district of Sangthong who has perhaps only two harvests and related main income streams per year, even if both are located in Vientiane Capital. In order to incorporate those differences in the analysis of demand for financial services following below we will make a link with the different types of Lao socio-economic society, including its trends and challenges.

55. **Lack of information on demand.** When trying to analyze actual demand, the lack of timely, empirically based information becomes apparent, even if information is not necessarily less available than in many other developing countries.[70]

56. **Direct sources.** Main sources of information on actual demand for RMF in Laos are an extensive, mainly quantitative study by ADB on (a sample of) rural households (Coleman 2006); combined focus group like and quantitative studies into demand for remittance facilities (Deelen 2010, Sisenglath 2009, Jampaklay 2009, Chanthavysouk 2006) and micro insurance (Lord 2010, Allianz 2006); and the chapter on the "Informal sector" in the 2007 version of the Private Sector and Investment Climate Assessment (ICA 2007), dealing specifically with micro and household enterprises. The Enterprise Surveys of the German organization for international cooperation (GIZ-HRDME 2010) also contains relevant information on and a separate analysis of (demand by) "micro enterprises", and makes a comparison with larger companies.[71] [72] [73] Recent relevant information and analysis on management practices and issues in family-based enterprises in Laos have also been used (Walsh 2011; Southiseng 2010).

57. **Indirect sources.** Important clues as to need for RMF services can often be found hidden in paragraphs and chapters of reports on rural and agricultural development. Last but not least, international research on the demand side of RMF has been consulted to get a more detailed picture on who the intended clients are, what the different characteristics of their socio-economic situation is, and what related coping mechanism are to deal with or prevent poverty, in particular their financial behavior and needs (Ströh 2011; Guérin 2009; Zeller 2000).

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[70] An indication of the lack of importance attributed to the demand side of RMF

[71] Which built on a UNCDF study with similar subject and methodology (Slover 1997)

[72] The sample used however is skewed towards tax registered or more formalized "micro enterprises"; the total number of tax registered enterprises in 2009 constituted only 40% of all "economic units" that have been identified in the Economic Census (MPI DOS 2007). So-called "green card" tax registrations for non-tax paying micro enterprises, in other words the ones with expectedly lower incomes, were excluded from GIZ's survey. In GIZ's overall surveyed sample of enterprises, only 145 (or 20% of the total sample) were tax-registered micro enterprises, which both on a total of 280,000 household-based enterprises and on a total of 210,000 economic units (within the latter group over 90% have been observed to be microscopically small) is not a representative number.

[73] The many other studies focus on the general business or investment climate (e.g. Doing Business, IFC) or focus on large, formalized companies (e.g. Invest Climate Assessments, World Bank), and because of the different challenges informal, micro, household businesses face, lack relevant information

1.2 Needed functions

58. **Main characterization: low income and wealth base, vulnerability.** The single most defining characteristic of low-income households is the fact that their income and wealth base are only just enough to afford life's basic necessities; food, housing and the means to make a living. Lacking leverage in income and wealth, fluctuations and unexpected setbacks in current income or in (the means to make) future income, or an increase in expenditures are all able to put mere survival on the line. As a consequence a constant strain is being put on households' financial managers' capacity to find ways to deal with uncertain and with fluctuating streams of income and expenditures, next to funding of income generating opportunities; this, while financial management and planning skills are often limited to beging with as a consquence of low levels of basic education.

1.2.1 Risk management

59. **Risk management tools.** Uncertain events have the largest impact on the socio-economic wellbeing of low-income households. It has been estimated that two thirds of rural households in Laos are at risk of becoming food insecure should a shock affect their livelihood.[74] As also found in international context, risk management or "insurance", is the main objective sought for by subsistence level low-income households when it comes to demand for financial services (Ströh 2011; Zeller 2000; Slover 1997; Kunkel 1997).

60. **Social and agricultural risk management.** Risk management is done in various ways. Next to engaging in interdependent social relations (through marriage, participating in important social events, reciprocal labor support, maintaining good relations with the rich people in the village to secure access to emergency funds), agricultural risk mitigating methods (using various crops, planting in different areas and sowing on different moments) and diversifying sources of income (e.g. engaging in other income generating business activities, having family members, mainly offspring, working in urban areas) there are "financial" solutions.

61. **Saving in-kind.** In Laos, in the absence of the availability of formal insurance, people are known to save, mainly in livestock (80-90%) and to a lesser extent in cash and gold, in order to build an emergency buffer.

62. **Emergency borrowing and its prevalence.** Next to saving, emergency borrowing is a main strategy used (Coleman 2006, Slover 1997). When looking at the reasons for borrowing, the poorer the household the more important dealing with an emergency becomes as a motive. In the poorest districts of Laos, 95% of households exclusively borrow for emergency purposes (Coleman 2006). This makes perfect sense, as taking on debt (e.g. for productive purposes) increases risk. For a family living on subsistence level, lacking leverage in income or wealth (a financial buffer), taking on extra risk by borrowing, or going into debt, could directly impact food

[74] 2006 "Comprehensive Food Security and Vulnerability Analysis" under rural households, the World Food Program

security in case a venture doesn't work out.[75] Yet, also in areas with lower poverty rates emergency loans are highly relevant, as found in experience with the large number of projects that have established village-managed loan funds (VMLFs); VMLFs have been created all over Laos in various settings, including urban, semi urban and in rural settings with adequate market access.[76] In a key-subsample of all VMLFs funding is fully based on monthly member contributions, in which after initiating the VMLF the total available funds build up over time. In the lending decisions by the VMLF management team emergency loans have first priority and only if funds are still available after all requests for emergency loans have been honored will productive loans be issued. In those VMLFs typically during the first 2 to 3 years all available funds tend to be lent as emergency loans.[77]

63. **Main traditional risks.** Main identified risks are those that impact agricultural production such as weather related events (e.g. flooding, drought, extreme cold), pests (e.g. mice) and diseases (both for crops or in animals being bred); death of a breadwinner (loss of income); hospitalization of a family member (expenditure); and loss of livestock.[78]

64. **Newly emerging risk profiles because of commercialization.** In the meantime agriculture in Laos is increasingly being organized as a commercial activity. As a consequence, different risks have emerged, directly related to food security. Farmers with little available land, sometimes as a consequence of concessions being given to foreign investors to grow crops for export at a large scale, are not well able to participate in the commercialization process. Communal land and forests are increasingly less available. As a consequence, subsistence farmers have to depend more on labor wages and have to buy food, making them vulnerable for food-price fluctuations and the dynamics of the market for manual labor. In particular those rural households with little available land, little access to natural resources and little diversity in sources of income have been found to be particularly vulnerable.[79] [80]

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[75] A simple numerical example will show this financial leverage effect. Suppose a family has 100 and borrows 300 at 5% to undertake a productive venture. If the total venture, worth 400, makes 8% overall, the return on investment on the initial capital is 17%, after repaying principal and interest. However, if overall the venture makes 3%, return on equity will be -/- 3%. In this case the negative outcome of the venture can mean lack of food. Mind you, the outcome is negative despite a positive return overall. In case the family has only 30 and makes 3% overall return will be -/- 17%: The lower the own capital or buffer, the stronger the negative effect.

[76] As we have seen earlier, these are the areas with most economic opportunities, production and higher income.

[77] Source: interview Mr Khanthone Phamuang, team leader Women and Community Empowering Project, a microfinance project implemented by the Lao Women's Union, a local MF consultant with some 15 experience in various projects.

[78] Funerals are also important peaks in expenditure in Laos, as they take many days during which all neighbors and friends are fed and entertained. However, in various ways, through the handing of envelopes with money or by bringing food, sometimes organized by village authorities or the VMLF organization, the concerned families are "insured".

[79] 25% of rural households have been found to be vulnerable to food insecurity when loosing access to natural resources.

[80] "Agriculture in Transition: The impact of agricultural commercialization on livelihoods and food access in the Lao PDR", Samantha Wright (July 2009). UN World Food Programme Laos Vulnerability Analysis and Mapping Unit, World Food Programme.

65. **Risk profile related to household composition.** Vulnerability for socio-economic shock (or in other words a household's risk profile or the likelihood of increased poverty) is also correlated with the composition of a household related to its income generating capacity. All members of the household depend on its income generating capacity, while increasing the number of members of the household doesn't necessarily imply a household will generate more income, such as in the case when children are young or when there is no need for extra labor in cultivating land or when an area has little productive opportunities.[81]

1.2.2 Matching cycles in income and expenditures

66. **Foreseeable fluctuations in income and expenditures.** Next to uncertain events there events that are wholly or partly foreseeable, yet similarly impact income and expenditure. Fluctuations relate to life cycle events (e.g. old age, marriage), to the seasonality of income cycles (e.g. agricultural cycles such as harvests and livestock raisin) and to day-to-day cash-in and cash-out flows (e.g. as part of trading activities).

67. **Life-cycle related fluctuations.** In Laos, the typical way in which old age used to be insured is through support by offspring. Currently, as economic production is changing from a predominantly subsistence agricultural setting, with little factor input in the form of capital goods (machines) and labor (people, children) as main production factor, to a more capital and knowledge intensive economy, a large number of offspring is not longer necessarily the best strategy. Alternative strategies are needed, which include financing of education and old age, and enabling payments between children working or studying the city and their parents in rural areas.

68. **Seasonal cycles.** Seasonal income and expenditure fluctuations, mainly within the span of a year, are plentiful. With agriculture being a main activity and agricultural production being generated in peaks, with the periodicity depending on the type of produce, and expenditures (e.g. in order to buy food or other necessities of life) being made gradually throughout the year, there is a need for storing and easy retrieval of produce or its monetary equivalent. Agricultural produce often needs to be sold immediately because of the need for cash for daily expenses, because of lacking (good-quality) storage facilities and related cost markup or a combination of both.[82] Without access to emergency funds, the position to negotiate the sale of agricultural produce is weak and people in distress are known to sell rice while it is still growing or its livestock (its safety buffer in kind) at steep discounts. Finally, the large numbers of people that do trading activities as form of income generating activity have huge number of daily transactions and are in need of "quick", liquid facilities enabling easy storing and withdrawal of cash.

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[81] "Population, Poverty, and Sustainable Development: a review of the evidence", Monica Das Gupta, John Bongaarts, and John Cleland (June 2011). Policy Research Working Paper 5719, the World Bank, Development Research Group Human Development and Public Services Team; "Impacts of Global Financial Crisis and Economic Crisis on Poverty: Lao CBMS sites", Phonesaly Souksavath (June 2010), Poverty & Economic Policy Research Network.

[82] Cost of storage itself, costs because of a loss of quality or amount of produce while in storage through pests, moisture or disease and (opportunity) costs of capital tie-up

1.2.3 Enabling use of economic opportunities

69. **Production in informal, household economy.** As seen earlier, economic production takes predominantly place in an informal, household setting and lacks adequate record keeping. The distinction with formalized, larger companies, organized as a separate (legal) entity and using (more adequate) record keeping is important both in terms of the efficiency and effectiveness of production as in terms of consequences for financial service delivery.

70. **Informality is profit maximizing strategy.** The fact that in Laos so many economic activities take place in "microscopic" enterprises is as much a consequence of a cost-benefit analysis as of anything else; it simply pays to stay informal. As large enterprises run the risk of being "detected" as an actual company and as their size suggests larger income volumes, they risk the burden of tax and administration related costs, both direct and indirect. Unnecessarily complicated and burdensome rules, procedures and accounting systems, combined with the weak positions in relation with the tax authorities, which are reported to act arbitrarily and unfairly, all drain heavily on small companies in Laos.[83] [84] As a consequence, enterprises do anything they can to stay "microscopic" or in other words, to stay below the radar. The benefits of larger companies, such as economies of scale and of scope, a stronger market position, or in general the efficiencies and effectiveness related to larger scale production, thus forego the Lao economy. Describing economic opportunities in their relation to financial service delivery it is important to reiterate the ultimate objective is effective and efficient economic production and consequential income generation, and is a result of a combination of different factors. Lack of access to finance experienced by "micro enterprises" can be a main constraint and adequate access can facilitate production by providing more adequate services, reduce risk or reduce costs. Still, for the micro enterprises of low-income and rural households to be able to be successful they need to be able to grow. To allow for this overall conditions, including but not limited to access to finance should be favorable.

71. **Dominance and characteristics household based economy.** Currently, as a consequence of combination of the unfavorable enabling environment and the family orientation of Lao society, the main organizational structure is the household or family enterprise. The nature of that type of organization brings with it some basic inefficiencies and challenges for financial service delivery; household-based enterprises maximize revenue per household member with the number of family members as an exogenously determined parameter, rather than profit; in family enterprises business income and expenditures are mixed with and partly indistinguishable from private income and expenditures; record keeping systems and practices are inadequate or absent; and last but not least, they are generally managed

[83] See Southiseng (2010); GIZ-HRDME (2010); ICA (2007) and Schneider (2006).

[84] Recently, April-May 2011 discussions on the subject have taken place in the Lao National Assembly and request have been made by assembly members specialized in economic affairs to abolish the current "presumptive" tax system, which creates opportunity for unfair taxation practices and corruption by tax officials, as the National Assembly members explained, (Vientiane Times, YouTube and the website of Lao National Assembly (www.na.gov.la)).

unprofessionally or in a disorganized manner and merely focus on handling day-to-day situations.[85] [86] [87]

72. **Savings and equity finance.** Financial services directly aimed at making use of economic opportunities include savings opportunities as a means to build capital to fund short and longer term business expenditures. Looking for funding from outside of the household, the informality of the household seems prohibitive for equity financing or participation. This, while there are clues that it is particularly long-term capital investment financing what is lacking (GIZ-HRDME-2010; ICA 2007) and what constitutes a constraint for expansion of business activities.

73. **Credit delivery and its challenges.** Formal RMF provision in the fomr of credit is faced with a multitude of challenges. Intended clients have weak management, are vulnerable for external shocks (and increasingly so for economic shocks) lack (titles proving) collateral or provide collateral which is its client's only source of food and housing, thus creating social problems around enforcement.[88] Assessing financial capacity of a household-based micro enterprise is a challenge because of the lack of record keeping, combined with the range of different sources and cyclical nature of income, and the mix of different productive and emergency motives for borrowing. In rural and even in semi urban areas, average distance between provider and client is large, (physical and technical) infrastructure is lacking, while there is a need for regular payments of small amounts from and to the financial service provider, the combined result of which is a heavy transaction-cost loading. Most importantly from the perspective of a RMF client when choosing a financial service deliverer, it should be available and willing to provide a loan when really needed.

74. **Costs and benefits related to borrowing.**[89] When assessing its available options when needing a loan, RMF customers choose on the basis of the overall benefits and costs of the relationship with a financial service provider. Costs involved in borrowing could be categorized as:

1. direct costs; interest and fees
2. transaction costs
3. opportunity costs
4. social costs
5. costs of non-repayment

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[85] You don't easily "fire" your son or daughter, in particular in the absence of alternative income earning (jobs) or receiving (social security) opportunities.

[86] In fact, separating them is tedious if possible at all in some cases, as a house can also contain storage, food is a main input for agricultural (and any type for that matter) labor and a motorbike transports people and goods regardless of whether they are sold or consumed.

[87] Walsh 2011; Southiseng 2010

[88] A legal setting in which it is generally difficult to enforce collateral rights anyway

[89] The analysis holds true for all types of financial services but here has been related specifically to loans for two reasons: 1-actual researched data are available on weighing the various costs associated with borrowing; 2- in the practice of Laos' RMF sector much focus has been on low interest rates, with strongly negative effects on overall outreach and quality of RMF service provision as a consequence.

75. **Interest and fees.** In Laos different definitions and calculations of interest rates are being used by different RMF providers. Including fees and other conditions, the total percentage of direct costs varies and is not always clear even to financially educated customers, let alone to financially less literate RMF clients.

76. **Transaction costs.** Transaction costs include issues such as loss of time due to travel to an office of a financial service provider or to complicated, inefficient procedures. The time could have been used to work, in case of replacement by staff there is loss of salary, while in case a shop is temporarily closed there is loss of revenue. Another example could be the costs of fuel or even lodging related to travel.

77. **Opportunity costs.** Opportunity costs could for example be the loss of a good relationship with an informal moneylender when taking on a loan from a formal institution, or the (fear for an) increased tax burden as a consequence of the tax department's awareness of the true amount of income when disclosing financial data to a bank.

78. **Social costs.** Social costs could be psychological considerations, such as a loss-of-face in case of rejection of a loan, the fact that a need for funding becomes known by peers or the public, or even the fact that details of a (bad) financial situation become known with officials of a financial institution and are feared to be known in a broader community.

79. **Non-repayment costs.** Last but not least, costs of non-repayment vary between different financial service providers. Some informal providers and pawn shops have been reported to use non-standard reimbursement methodologies and require land titles as collateral. As a consequence borrowers are vulnerable to loose their land over an initially borrowed sum which is less than a half and often a third of the land's value.

80. **Data on actual cost valuation in Laos.** The various costs mentioned are often overlooked yet are most relevant to RMF customers. ICA (2007) finds "cumbersome and time-consuming procedures and paperwork" are a main constraint for micro enterprises to access loans. Coleman (2006) finds when rural households evaluate loan providers "confidence that a loan will be made" is the most important criterion, indicating the weight of the opportunity cost of foregoing an informal moneylender as a break up of the relationship has the consequential risk of loosing access to emergency funding. Coleman (2006) found various other criteria, such as a short journey to the source of the loan, the level of the rate of interest and the availability of long-term loans were all considered by rural households to be roughly equally important, followed by low collateral requirements and simple loan procedures. Interestingly, the richer a household, the more the interest rate becomes a consideration.

81. **Credit summary.** For successful loan delivery, a financial provider needs to deal with information asymmetry, provide a high level of flexibility in terms of loan conditions and with regard to the purposes for which the borrowed funds are being used, needs to be a secure, long-term provider and needs to deal with a set of highly

relevant costs not directly related to the loan itself.[90] That this is not an easy task can be concluded from various surveys showing lacking access to finance, in terms of access to loans, is the main constraint for "micro enterprises" (Southiseng 2010; GIZ-HRDME 2010, 2008 and 2006; ICA 2007; Coleman 2006 and an interview with the Young Entrepreneurs Association Laos held in 2011).[91]

1.2.4 Financial connectivity

82. **Large scale labor migration to Thailand: remittances.**[92] Demand for tools enabling financial connectivity and the contribution to poverty reduction can be deducted from results of surveys on labor migration to Thailand.[93] Estimations of the number of Lao nationals in the overall group of labor migrants in Thailand range between 260,000 and 400,000 or between 8% and 12% of the Lao workforce. The Lao labor migrants are from low-income, rural families and almost all send money home. An estimated 0.9 to 1.5 million people in Lao depend directly on the funds and goods remitted for the provision of income needed for their daily cost of living.[94] For over 50% of concerned households, the remittances form the main source of income and on average the remitted funds more than double pre-migration household income.

83. **Remittances: use and function.** The remittances are used to pay for a range of different types of expenditures, including prominently daily expenses and healthcare related services. The latter is indicative of the relevance of remittances as a form of "insurance", further confirmed in the large number of (older) people in recipient households that retire following the reception of remittances. Other main use is on expenditures for education and on building wealth, predominantly in the form of building or expanding houses. Inferences made based on the surveys were that the way in which the remittances are used show the importance of risk-management as a motive for low-income households and that households have an array of different types of expenditures and different sources of income, making it

[90] An example of how creating a more flexible product with lower transaction (in this case through improved distribution methodology) can be successful is when a licensed, formal MFI introduced Grameen methodology based "center meetings", where credit officers visit villages to collect payments (savings, loan principal and interest payments) periodically with little time between the visits, loan repayment and the number of clients strongly increased. This innovation decreased transaction costs of customers (gasoline, no time loss, and no loss of availability of the micro entrepreneur for his enterprise) and provided convenience, for which there is great demand.

[91] The most recent ICA (2011) found lack of qualified labor the 1st, and burdensome tax and administrative procedures and practices the 2nd most important constraint, with access to finance only the 3rd most important. However, this survey has been done under registered, non-agricultural companies in manufacturing, construction, services and transport, storage & communication, 60% of which had 10 or more staff and all of which had more than five staff. As a consequence, the survey is less representative for our RMF target group and misses the largest group of enterprises in Laos, 90% of which as we have seen have less the five people working.

[92] Remittances for the purpose of this chapter are seen to be monetary remittances. The import into Laos of technology, ideas, skills and knowledge, which are certainly important, non-tangible, benefits of labor migration are merely mentioned to be complete.

[93] The results of the surveys (e.g. Deelen 2010, Sisenglath 2009, Jampaklay 2009 and Chanthavysouk 2006) on which the assessment is based vary slightly, likely due to the small samples used, and show small inconsistencies; however broad trends and the range within which true numbers can be expected to be found are inferred from the reports.

[94] Percentages found most recently were 88% (Jampaklay 2009) and 95% Sisenglath (2009).

difficult to allocate one source of income to a specific type of expenditure, both for conceptual reasons and for lack of record keeping.[95] Next to the direct effect on poverty reduction by funding life's basic necessities and the long-term productive use by paying education, remittances have a potential positive effect on a household's productivity. By raising overall family income and diversifying its sources, the low-income household's risk profile has been reduced. The increased capacity to deal with an economic setback allows for economic activities with potentially higher rewards to be undertaken. Even if used for daily expenses, remittances raise overall income and enables freeing up of other sources of income for productive purposes.

84. **Information determines remittance methodology.** The choice of the method used to remit is mainly based on the information that is available to the remitter; two thirds choose a method based on information received from friends or family and 44% of the remitters know of only one available method. As the known methods are informal almost all remit by bringing money during a home visit, through family and friends visiting home or by sending money through informal agents. Over 80% remit in the national currency of Thailand, the baht.

85. **Remittances via banks.** Traditionally Lao people are not familiar with using banking services. Although specific data are hard to get by, generally the percentage of people in Laos with a bank account is estimated to be below 15%.[96] Against the background of the low level of familiarity with the use of banking services and knowing the method of choice to remit is based on information available to migrants, it is not hard to understand that only 20% of Lao labor migrants prefer sending money home through the banking sector and only 15% actually use banks to remit. Interestingly, of those using a bank to remit, 93% consider it a convenient, fast, reliable and cheap channel. In a sample of surveyed labor migrants in Thailand from Laos, Myanmar and Cambodia using the banking channel to remit most were Cambodians, as a consequence of ACLEDA Bank's large outreach in Cambodia.

86. **Costs involved in remitting.** Direct costs incurred in remitting from Thailand to Laos vary between 3% and 8% based on average typical amounts sent per transaction. Apart from direct costs there are additional costs and risks involved. As money is transferred in cash and as receivers lack bank accounts, it needs to be collected, leading to transportation costs and costs for international phone calls made for confirmation. The method often used by Lao migrants to (have friends and family) carry cash across the border is risky for registered migrants and even more so for informal migrants. Money can be stolen or, as found in surveys on migration, it can be extorted by Thai and even Lao officials. When using informal agents, problems have occurred for some 16% of receiving households. Based on this information it could be inferred that if labor migrants would be adequately informed about the possibility of remitting through banks before departure, the number of Lao migrants using the formal financial sector to remit could well increase. A related issue that need to be dealt with is that many Lao lack a proper ID or migrate without

[95] For example, the conceptual difficulties with determining the nature of certain types of expenses; for example, rice and food intake is needed to live and can be considered a personal expense yet is the main input for labor-intensive agriculture's main production factor, labor.

[96] Source: statements made by officials from BOL and a commercial bank. Sisenglath (2009) measured 7% in his sample, Jampaklay (2009) 21% in his. No specific data have been provided for this assessment.

required documentation, as in particular ID requirements are found essential for the use of banking services.[97] [98]

87. **Large scale rural-urban migration inside Laos: (national) money transfers.** Next to demand for international money transfers or remittances there is large demand for money transfers within Laos.[99] This inference is based on the scale, growth and nature of rural-urban migration, and on data provided by a main provider of money transfers, the LPFI. The number of money transfers handled by the LPFI alone has tripled over the last 6 years, despite the fact that competition by an increased number of commercial banks has taken a bite out of LPFI's money-transfer market share. In 2010 the LPFI handled over 900 money transfers per working day at an average of $40 per transaction. The way money is being transferred is mainly cash-to-cash (or "without-account" to "without-account").[100] Within Laos there are relatively good facilities for national money transfers in terms of low requirements for documentation of identity and low direct costs. Still, indirect costs (transaction costs, opportunity costs) are high due to huge distance to financial service providers outlets combined with the need to make or receive regular transfers in small amounts.

1.3 Consequences of the commercialization of agriculture

88. **Consequences for demand.** As seen earlier, two main trends can be observed in the process of commercialization of agriculture, the use of the value-chain approach and contract farming. Commercialization of agricultural production is a main strategic objective of the government and has recently received increased attention following the 9th National Congress of the Lao People's Revolutionary Party (LPRP).[101] A related issue is that of food security. Commercial production, mainly for export, decreases the amount of land, labor and agricultural produce available for the Lao market, and can create food shortages at micro and macro level. Only if the extra money earned through commercialization can buy enough additional food supplies, mainly via import, will the net results be positive again at both micro and macro level.

89. **Warehouse-receipt financing feasibility.** As a consequence of the need for food security and as a part of the commercial activities organized in Lao farmers' enterprises and associations, storage facilities are being planned and built. As good-quality storage becomes available on a larger scale, the opportunities offered by "warehouse-receipt financing" emerge. In the basic concept of "warehouse-receipt financing", agricultural producers deposit their products in a storage facility for

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[97] I have not been able to find exact data on the percentage of Lao people without proper ID card or passport. Anecdotal evidence suggests a substantial number of Lao could not even be registered at birth.

[98] Services such as Western Union do facilitate remitting with low ID requirements, yet are relatively expensive when sending small amounts

[99] No survey results have been found on demand of this type of service. Data on actual transfers have been provided only by some individual providers.

[100] No information is available on the amount or relevance of informal money transfers within Laos

[101] The LPRP exercises and ensures the rights of the Lao people to be master of their country through the functioning of the political system of which the LPRP is the leading nucleus, as embedded in articles 2 and 3 of the Constitution of the Lao PDR.

which they receive a receipt. The receipt serves as collateral for credit facilities provided to the farmer by a commercial bank. Benefits for the farmer are a stronger negotiation position when selling their harvests (no pressured selling because of a need for cash to buy food), less loss of produce during storage (professional storage is better) and improved market power by being able to time the sale until after harvesting season (immediately after harvesting all farmers want to sell, depressing prices and revenue for farmers). Warehouses and warehouse-receipt financing have improved revenue for farmers in various parts of the world and studies have identified conditions for success, adding variations to the basic model. For Laos, an in-depth feasibility study should be undertaken to assess need, scope, success factors and constraints. The study, potential follow-up strategies and action should all have a multi-sector approach and should include stakeholders involved in agricultural development and poverty reduction as well as from business and financial sectors. The stakeholders should include governmental agencies, development organizations as well as private sector actors.

90. **Contract farming and RMF providers' involvement.** Finance is a main element of contract-farming agreements. As input is provided by the buyer and contractor in the framework of the farming contract, and as the contract determines delivery conditions including price and quantity of the deliverable agricultural produce, implicitly both amount and price of funding are agreed. In particular for subsistence farmers the mutual lock-in that is provided by farming contracts with funding included can be his only choice and provide certainty about revenue. For farmers that are financially able to run a risk more choice in financing arrangements within the farming contract could be desirable, as it could bring freedom to sell at market price and time the moment of selling. For financial service providers, to engage in funding farming contracts could reduce risk as there is more certainty of revenue of the funded activity and could extend their market. Again, study into scope and exact demand is necessary, and should provide relevant information to all market participants.

1.4 Socio-economic challenges and patterns of poverty

91. **Urban.** Contrary to notions often held, the number of poor households is largest in urban areas.[102] The same urban areas also have the highest economic potential and population density. Most Lao poor live in an urban area in which they are surrounded by a large number of people better of than them and in effect are a minority. The benefits offered by economic growth elude these households as a consequence of individual household related characteristics, such as size and composition, level of education and place of residence (Epprecht 2008). As a consequence of rural-urban migration, urban poverty has been growing and can be expected to increase if current trends are not adjusted. The young, lowly educated migrants are dependent on wage labor for income and have to buy food and housing, which makes them vulnerable for rising consumer prices for housing, electricity, fuel and last but not least, food. Those without family in the city lack a socio-economic

[102] Phrased differently, density of poverty is highest in urban areas. The poverty rate, which is the percentage of poor households of the total number households, is largest in remote, rural areas. The difference is of course a consequence of the difference in population density

safety network. Individual household characteristics also influence vulnerability of households in rural areas with market access (rural with-road or rivers). In rural areas, in particular those households that are asset (land) poor, have little access to natural resources and have little diversification of income sources are in a more food uncertain situation, have little shock absorptive capacity and have less potential to participate in the process of commercialization of agriculture. The fact that poverty is related to characteristics at the household level stresses the importance of regularly collecting and analyzing data, and building or adapting strategies based on information found.[103]

92. **Rural.** For rural areas without road or without access to rivers, poverty is much more a consequence of general factors with consequences for all people living in those areas. In particular the lack of access to markets as a consequence of lacking infrastructure and education is the crucial factor. Logically, the number of poor households as a percentage of total number of households in rural without-road areas is high, as the households lack opportunities due to characteristics related to the area in which they live. Logically also, population density is low, as few people like to live in an area with little opportunity. Here, poor households are surrounded mostly by other poor. In the meantime, official statistics have found currently 19% of households overall can be classified as poor.

1.5 Conclusions and financial service needs

93. **Microfinance is an underserviced mega market.** In terms of demand, there is a large rural and microfinance market in the Lao PDR or in other words, microfinance is a mega market. The rural areas house 68% of the population and over 90% of "enterprises" are "micro enterprises" which give employment to over 80% of the workforce. The share of "low-income" households is more difficult to determine if only because the concept hasn't been clearly defined, but at least we can say that in rural areas two thirds of all households are vulnerable to food insecurity in case of socio-economic shock even when most poor households can be found in urban areas.[104]

94. **Need quality data and information on RMF clients.** Data collection and measurement of socio-economic characteristics of low-income and rural households is as important as it is difficult. It is important because different groups of rural and low-income households have different characteristics and consequential different needs in terms of financial services. It is difficult because RMF clients operate in a largely informal economy, outside of official statistics and do not keep adequate track of their financial dealings, aggravated by the fact that the financial aspects of household based economic activities are often indistinguishable from private activities. The relevance of good quality data collection is also clear from the observation that income and poverty levels correlate with household characteristics. Defining, collecting and analyzing data on relevant household characteristics and on

[103] Also: Komoto, G., and S. Stone. 2009. Determining Poverty Impacts on Lao People's Democratic Republic and Cambodia: Reconciling Household and GTAP Data. ADBI Working Paper 141, Asian Development Bank Institute, Tokyo; Epprecht (2008)

[104] Most poor households in Laos are found in urban areas (Epprecht 2008).

related characteristics of specific demand for RMF services is a prerequisite for building specific strategies needed to meet demand of the different RMF market segments, to measure effectiveness and to adjust a chosen approach. Currently, there is little ongoing data collection of relevant parameters linked with RMF demand while at the same time various census surveys are regularly undertaken by the DOS of MPI.

95. **BOL led data collection and analysis on demand and supply should be institutionalized.** Collection of data and information on the economy and on the formal financial sector for the purpose of improving the formal financial sector's effectiveness is a responsibility of BOL.[105] The newly adopted Law on Statistics requires all economic and social statistics, including those on the banking and insurance sector as well as on social security and poverty, either to be done by or to be certified and approved by the DOS of MPI.[106] As seen from the analysis in the previous paragraph, relevant, accurate and timely information is crucial for designing effective strategies in RMF sector development. For this reason it is highly recommended to build in a set of questions in the various census surveys specifically aimed at characterizing and localizing RMF demand, based on in-depth focus-group methodology surveys. The surveys should be done jointly designed with other relevant beneficiaries and stakeholders, in particular with the DOS of MPI, the Ministry of Agriculture (MAF) and the Prime Minister's Office.[107] In the meantime, based on currently available information, an attempt has been made to summarize RMF demand in the paragraph following immediately below.[108]

96. **Social programs.**[109] For households in areas without road or river access, where poverty rates are high, social programs (e.g. food or cash-for-work program or direct food support, social and health insurance) providing direct relieve of immediate needs such as food shortages and access to health care remain necessary, just as increasingly so for vulnerable groups in rural with-road and urban areas. These groups live in a situation on or below subsistence level.[110] The economic

[105] Article 5.3 (Duties of BOL) of the Law on BOL (05/NA, 14/10/1995): To collect, compile and analyze information and data relating to economic and financial matters, the currency and the operations of banks and financial institutions from concerned persons and sectors within the country and abroad, in order to serve the formulation of monetary policy and the operation of the banking sector.
Article 2.7 (BOL has the following duties) of the Prime Minister Decree on BOL (40/PMO, 06/04/2000): To collect and analyze information on the economic and financial situation, currencies bank activities and activities of the financial institutions, individuals and concerned sectors both within and outside the country. The information shall be used for planning monetary policy and banking activities.

[106] Articles 9, 10 and 19 of Law on Statistics (03/NA, 30/06/2010).

[107] For MAF it should include the National Agriculture and Forestry Extension Service or NAFES

[108] The National Leading Committee on Rural Development and Poverty Eradication

[109] Even though it can be argued that social programs are not microfinance, they are mentioned here. Low-income households sometimes need incidental social support, such as food hand outs in case of an emergency or maybe just for 2 months per year. At the same time they are or can be "real microfinance" clients and need for example to save the monetary proceeds of the sale of their rice harvest or receive funds from a child working in the city. In other words, microfinance and social programs are sometimes overlapping and complementary issues, and should be not looked at in isolation.

[110] In the design of the programs, it should be made sure food production is not harmed, as it has been registered, mainly in some post-disaster areas, that cash-for-work programs sometimes create higher

opportunities and poverty rates of the population in these areas are determined by factors influencing the overall economic or investment climate, such as availability of physical and technological infrastructure, education and in general access to markets (Epprecht 2008, ICA 2007). Lending programs for productive purposes is a less effective strategy and can actually work counterproductive by putting the population in a debt trap and further into poverty. The vulnerability of groups in rural with-road and urban areas is more determined by household specific characteristics and poverty of individual households should be assessed accordingly. In the urban areas, the social programs should be complemented with support to (members of) households to bridge the gap to the ample available productive opportunities and guide them to find their way in the job market.

97. **Insurance.** The main motive for RMF clientele is risk management and insurance is the financial product aimed at just that and could in cases prevent low-income people from becoming destitute poor ones.

98. **Agricultural insurance.** Specifically for rural areas the main identified risks are those related with agricultural production and death of livestock. Relevant products are various types of agricultural insurance, such as flood-index insurance, weather-index insurance (e.g. based on temperature or rainfall), or livestock index-based insurance. For borrowing farmers a more general loan guarantee products could insure both the agricultural risks already mentioned, but also other ones such as pests, or extreme market price volatility. The insurance products mentioned could both protect low-income subsistence farmers from becoming really poor and in urgent need, as well as stimulate commercial agricultural production by reducing risk for farmers, traders, buyers and/or investors.

99. **Life, health and social insurance.** Main identified idiosyncratic risks are death or invalidity of a breadwinner and hospitalization of a family member, which are affecting households in all parts of the country. Typical individual life, accident and health-insurance products would provide needed coverage. A social-insurance system would do the same and in as far as it is paid for by employers and employees delivers what is needed by low-income households in a sustainable way. Since (almost) all companies formally hiring staff are found in urban areas, this type of products is needed there. Regarding private, commercial insurance, Allianz (2006) roughly estimated the potential (maximum) number of customers to be some 367,000, based on general analysis of the income situation the Lao population.

100. **Savings.** As a RMF product, savings have the interesting characteristic that they service customers based on three main but different motives; allowing the build-up of capital to invest and make use of productive opportunities, managing the cyclical nature of income and expenditures, and building an emergency buffer as form of “insurance”. Moreover, the demand made on family members that hold cash to hand it over for direct, yet possibly not wise spending decisions is mitigated. Indeed savings are found to be the main product used by RMF clients in terms of number of clients if available. As often found in international context, the number of customers of an RMF provider that save is often a multitude of the number of

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income for farmers than doing actual farm work, harming (the restart of) agricultural production and self reliance

101. **Remittances.** There is huge demand for money-transfer facilities, both within Laos as from Thailand to Laos. Interestingly and surprisingly, remittances so far have been an overlooked element when assessing the RMF sector of the Lao PDR. This, while remittances make up a huge part of GNI of many developing countries and of the Lao PDR in particular. The IMF estimates the total amount of remittances to the Lao PDR to contribute about a third of GNI in 2009 which is close to the 34.5% of GNI found in another study commissioned by IFAD.[111] [112] The lack of attention may have been caused by the focus on GDP rather than GNI in socio-economic development policies or by the lack of reliable, publicly available statistics.[113] Remittances have direct and large scale poverty reducing effects, are in demand over informal means of remitting and have the e potential to contribute to both size and efficiency of the formal financial sector as a whole while lowering costs and risks of remitting.[114]

102. **Money-transfer facilities.** The increasing urban population (700,000 extra over the last 10 years) and labor migration to Thailand (between 250,000 and 400,000) have led to grown demand for inexpensive, flexible and save ways to send money home by young Lao to their parents and siblings, the latter group a multitude of the total number of migrants. Looking at the estimated amounts remitted from Thailand, a 2% decrease in direct costs alone would mean an additional $3 to $7 million would reach Lao low-income households per year, or $30 million to $70 million over 10 years, all other things being equal. Improved remittance facilities would further reduce transaction costs and loss as a consequence of theft.

103. **Payment facilities and outreach as necessary condition for provision of other financial services.** Not less relevant, a lack of flexibility and outreach in payment and money-transfer facilities is also a main constraint for expansion of insurance, saving and credit services to low-income and rural households. Improvements in financial connectivity would increase access to these other financial services by reducing transaction costs, and by enabling payment frequency and timing to match the cash flows of RMF clients. Health insurance, private insurance,

[111] Kristin Johnson Ph. D. (February 2010), "Many Happy Returns: Remittances and their Impact", Immigration Policy Center, American Immigration Council.

[112] Sending Money Home: Worldwide Remittances Flows to Developing Countries", Dr. Manuel Orozco, of the Inter-American Dialogue, commissioned by the International Fund for Agricultural Development
titled "Sending Money Home: Worldwide Remittances Flows to Developing Countries"

[113] As an illustration may serve the confusing and blatantly incorrect information found in the World Bank's "Migration and Remittances Factbook (2011)"; it knows the exact number of Lao working outside the Lao PDR to be 366,600 people, yet states the total amount remitted to be only $1 million. This number can certainly not be taken too seriously; data provided by only two small commercial banks for this study already amounted to a total of $95 million in remittances.

[114] Arusha Cooray (), "Migrant remittances, financial sector development and the government ownership of banks", School of Economics, University of Wollongong, Australia.

savings and loans in the RMF segment all deal with the necessity to allow for the flexible handling of many small periodical and non regular payments, such as premium for insurance, small savings, loan principal repayments and payment of interest. A main obstacles for improved outreach of health insurance and for improving the health care system itself, is exactly this; the current impossibility of providing an easy, accessible way to make payments from the customer to the insurance provider.[115]

104. **Loans.** As with savings, loans can serve three purposes; they can help smooth income and expenditures, can be taken out in case of an emergency and can help fund productive activities. Still, borrowing is really being “in debt” and since being “in debt” comes with costs in terms of interest due and a raised risk profile, low-income households hesitate to borrow and for good reasons. Borrowing for various productive purposes is mainly needed in urban areas and in rural areas with adequate market access, where micro enterprises are prevalent as a consequence of the economic opportunities. Emergency borrowing is needed all over the country. Coleman (2006) estimated need for credit among rural households to be $500 million. Typically observed average loan amounts for individual loans to RMF customers range roughly between $250 and $2,500, based on data collected from different types of known RMF providers. The further away from (the centre of) an urban area, the lower the average borrowed amount.

[115] The adequate functioning of which is a necessary condition for health insurance. This cycle that could be broken by adequate financial connectivity.

2. Supply

2.1 Information and transparency

105. **Lack of information is main constraint.** Publicly available, reliable and relevant information on the financial sector is in short supply. This lack of available relevant information on the financial market has even been seen to be “likely the single most significant impediment to the development of the sector” (Flaming 2010; also Lord 2010). Some industry information can be found in quarterly financial sector statistics and annual reports that have been issued by BOL up until 2010, and in the Financial Institution Development Strategy. These documents give aggregated data and lack information on basic parameters that could indicate the soundness of the financial sector but for the overall percentage of Non Performing Loans (NPL). Information on individual institutions is more difficult to find.

106. **Causes.** The lack of information has various causes and takes on different shapes.

107. **Lack of publication, often despite legal obligation.** Despite a legal obligation for commercial banks to publish an annual report and hand out free copies to the public, an obligation which has been in existence since 2006, only two of all 24 licensed banks so far have fully complied, while another publishes some basic financial information on its website. Licensed MFIs, either shareholder-based or member-based, are obliged to be externally audited on a yearly basis and publicly display their annual report. So far none of the 22 institutions has complied. For insurance companies, leasing companies, pawn shops and the LPFI, all of which have been licensed by the financial sector authorities and are part of the formal sector, no obligation to publish an annual report exists and none of them do voluntarily. Significantly also the Depositor Protection Fund (DPF), created to protect deposits and install trust in the banking sector, does not produce any (public available) report. An exception is the Social Security Organization (SSO), which does produce an informative report in Lao language even if it is not audited.

108. **Low accounting standards: published reports lack reliable information.** Apart from banks and insurance companies very few companies in Laos are externally audited. Still even if audited, Lao Accounting Standards (LAS) compliant financial statements “are hardly useful for decision making by market participants” (WB and IMF 2009, pages 11 and 13). On top of that, compliance with LAS in itself is not a given, as a consequence of lacking basic accounting capacity, lack of monitoring capacity and a lack of enforcement (WB and IMF 2009, pages 11 and 13). As a consequence, stakeholders, including significantly the monetary authorities, (potential) commercial funders, and the owners, managers and customers of financial institutions lack a solid basis for making good-quality rational decisions. Financial sector assessments are also impeded. The overview given below is based on publicly available data and on additional information received during interviews with some individual institutions.

2.2 Formal sector

109. **Definition of formal and semi-formal.** RMF services are delivered by both formal and semi-formal providers.[116] Formal are considered those financial institutions that have been licensed and supervised by the officially designated financial sector authority; semi-formal providers are those that operate outside the financial authority's supervision but have acknowledgement from the government or mass organizations.[117] For financial sector authorities, both semi-formal and informal providers, the latter such as family members, friends or money lenders, are outside of their scope.

110. **Types of formal finance sector RMF providers.** In the Lao PDR the group of formal and semi-formal RMF service providers consists of:[118]

111. **Banks**: commercial banks (20) and one Policy bank, supervised by BOL's Banking Supervision Department (BSD).

112. **Non-Bank Financial Institutions**: A diverse group of non-bank, non-insurance financial institutions supervised by BOL's Financial Institution Department (FISD), amongst which licensed MFIs, the Lao Postal service Financial Institution (LPFI), licensed Pawn shops and the telecom provider Lao Telecom.

113. **Private or commercial insurance companies**: A group of licensed private insurance companies, supervised by the ASEAN Division of the Fiscal Policy Department of the Ministry of Finance (MOF).

114. **Social insurance systems**: A Social Security Organization (SSO) for the private sector monitored by the Ministry of Labor and Social Welfare (MLSW) and a Civil Service Scheme (CCS) with a State Authority for Social Security (SASS) for civil servants, administered by the MOF and the MLSW.

115. **Health Insurance**: A Community Based Health Insurance (CBHI) and a Health Equity Fund (HEF), administered by the Ministry of Health (MOH).[119]

116. **Semi-formal RMF providers.** The group of semi-formal RMF providers consist of a village based and managed loan funds. Formally all need to register with the financial sector authority, based on a regulations issued by BOL and a Prime Minister Decree that made BOL responsible for management of the microfinance sector. However, in more recently issued financial sector strategies BOL proposes

[116] Informal providers (e.g. family members, "money lenders") are not explicitly described in a separate paragraph or chapter. This doesn't mean informal supply does not exist or doesn't play an important role as RMF supply source, quite the opposite is true. The assessment however is intended to find ways to support the development of the formal sector we describe its current situation. Informal providers will however be mentioned where relevant.

[117] The Lao PDR has four mass organizations with a socio-political mandate embedded in the Constitution. They answer to the LPRP and operate largely outside the formal government, within the bounds of the Constitution and the Laws.

[118] Data June 2010

[119] Both health-insurance schemes could well be considered mainly semi-formal. I have chosen to mention them here to facilitate sector oversight.

these VMLFs to stay under the responsibility of the authorities that instigated the funds.

117. **Regulation and supervision.** Regulation and supervision of the various types RMF providers is spread out over a range of different parts of the government. The matrix that follows immediately below will give an overview and is followed by an overview of all formal financial sector service providers.

Table 4: Supervision oversight matrix

Financial Service Providers by type	Responsible Government Agency for Supervision
1. Provision by Banks	Banking Supervision Department of Bank of Lao PDR
2. Provision by non-bank, non-insurance formal financial service providers	Financial Institution Supervision Department of Bank of Lao PDR
3. Provision by semi-formal "village-managed loan funds"	- Various government organizations (Ministry of Planning and Investment, Ministry of Agriculture and Forestry, National Leading Committee on Rural Development and Poverty Eradication at the Prime Minister's Office) at all levels - Various mass organizations (Lao Women's Union, Lao Front for National Construction) at all levels - The Financial Institution Supervision Department of BOL is the responsible financial sector authority.
4. Provision by commercial insurance companies	Fiscal Policy Department of the Ministry of Finance[120]
5. Provision through Social Security Organization	Ministry of Labor and Social Welfare
6. Provision through Community Based Health Insurance Schemes	Ministry of Health

118. **Overview formal finance sector providers.** Immediately below in table 5 a time series will detail the types of different providers and the increase in their numbers over the last 7 years. Following the outline in table 5 a summary of the various types of providers will be given including main developments over the last five years. It will include an overview of supply first by formal providers followed by supply through semi-formal providers.

[120] The Ministry of Public Security is responsible for one insurance company in which it holds a stake according to the Prime Minister "Decree on the Financial Institution Development Strategy of the Lao PDR 2009-2020" (No. 273/PM, 22/09/2009) and BOL's Financial Sector Strategy of 2008. However, according to the MOF only the Fiscal Policy Department of MOF is responsible.

Table 5: Formal financial service providers and outlets over 2003-2010

Financial service providers (year-end)	**2003**	**2006**	**2007**	**2008**	**2009**	**2010** [121]
Number of Commercial Banks (incl. representative office)	**13**	**13**	**14**	**16**	**20**	**20**
Foreign Owned Commercial Banks	7	7	7	9	12	12
Lao Privately Owned & Joint Venture Banks	3	3	3	3	4	4
State-Owned Commercial Banks	2	2	3	3	3	3
Representative office	1	1	1	1	1	1
Policy Bank (non commercial)	1	1	1	1	1	1
Distribution channels banking sector, in numbers						
Bank Branches	42	42	50	60	66	85
Bank Service Units	na	na	72	116	129	200
Money Exchange Units	na	na	21	24	29	33
ATMs	0	12	44	111	189	245
Staff	na	na	2,571	2,731	na	3,300 [122]
Number of Non Bank Financial Institutions						
Licensed Pawn shops	2	13	14	15	21	23 [123]
Licensed Leasing Companies	na	na	na	na	5	4
Companies licensed to transfer money [124]	na	na	na	na	na	7
Total number of agents for international money transfer companies [125]	na	na	na	na	na	18
Total number of Foreign exchange outlets	na	na	na	na	na	365
Lao Postal Financial Institution [126]	1	1	1	1	1	1
Licensed Deposit Taking MFIs [127]	0	1	2	2	4	8
Licensed Saving & Credit Union [128]	2	8	8	12	14	14
Licensed Funds	0	2	2	2	2	2
Insurance						
Licensed private insurance companies	1	1	2	3	5	6 [129]
Social Insurance	2	2	2	2	2	2 [130]
Source: BOL						

121 30 June 2010
122 Informed estimate
123 The number of pawn shops has earlier been 28; dissolved pawn shops have not been included.
124 Companies other than banks
125 Including banks
126 The Lao Postal Financial Institution has 18 branche offices and some 135 postal outlets
127 Within the group of 22 licensed MFIs, 10 separate branche offices have been established; one branche has received a separate license but has been consolidated with its head office in table 5.
128 Including SCUs in BOL and Enterprise of Telecommunications Lao
129 AGL works with a network of some 100 agents, 2/3 of which operate in Vientiane and 1/3 in other urban areas. Toko Insurance also has a network of some 100 agents.
130 One for civil servants; one for (larger) private companies

2.2.1 Banks

119. **State owned banks (used to) dominate the formal financial sector.** Traditionally, the formal financial sector has been dominated by banks, together holding over 97% of all assets owned by the financial sector overall as recent as June 2008. Activities in the banking sector were further mainly concentrated in state-owned banks, which together owned 67% of all assets in the banking sector at that time. The SOCB "Banque pour le Commerce Exterieur (BCEL)" alone owned 35% of all banking sector assets.[131] Until 2007, all privately owned banks used to have single office in the capital Vientiane and only a limited number of staff.[132] The group of private banks consisted of small subsidiaries of Thai and Malaysian banks catering to home-country clients doing business in Laos and of three joint venture banks servicing a small group of companies and wealthier individuals. Private banks used to operate almost exclusively in the capital Vientiane.

120. **Banking sector background.** For a long time state-owned banks neither selected, evaluated or managed staff based on merit or results. Their loan allocation depended on the ample availability of collateral (land titles) and a relationship-based, politicized decision making process. As a consequence, the three state-owned banks used to be characterized by low outreach, a high percentage of NPL and negative Capital Adequacy Ratios (CAR). Indicators of financial intermediation by the formal financial sector showed low values, lower than countries with similar level of economic development and lower than other countries in the region. At that time, the state-owned Agricultural Promotion Bank (APB) was still a policy bank and was the only bank servicing the RMF segment.

121. **ADB assisted restructuring state owned banks.** Over the last decade the state-owned banks have been restructured both financially and organizationally in two main financial sector restructuring programs supported by ADB.[133] The ultimate objective of was turn them around to become market-oriented, self-sufficient commercial banks as proclaimed by the government. As part of the restructuring, APB split of its portfolio of policy loans and its policy mandate which both were taken over by a newly created state-owned Policy Bank or Nayoby Bank (NBB). NBB is a non-deposit taking government policy bank created by BOL to distribute subsidized, low-interest loans funded from the government's budget to areas with high rates of poverty or to companies that buy or process agricultural produce from these high poverty-rate areas. Following restructuring, the three SOCBs (BCEL, APB and the Lao Development Bank (LDB)) have made a profit and show strongly reduced NPL. CAR for the SOCBs is now positive because of capital replenishment by the government and partly due to retained earnings.

122. **Strong increase in lending by SOCBs since 2007.** Lending by state-owned banks has strongly increased since 2007 on instructions by the government delivered by BOL. APB and LDB, the two banks with the largest outreach in terms of branches, service units and staff, have adopted loan assessment techniques which rely

[131] BOL (2008), Financial Sector Strategy.
[132] BOL (2009), Financial Sector Statistics.
[133] Banking Sector Reform Program and Rural Finance Sector Development Program.

on a borrower's financial capacity to repay and his willingness to do so (character or morality) rather than on the mere availability of collateral and connections.

123. **Market entry private commercial banks since 2007.** Simultaneously, induced by the promulgations of the Amended Law on the Promotion of Foreign Investment (2004) and the (new) Law on Commercial Banks (2007) the number of private commercial banks has strongly increased.

124. **Extreme growth loan portfolio since 2007.** As a consequence of both developments mentioned, the number of branches, service units, ATMs and staff in the overall banking sector has grown significantly. Stronger even has been the growth of the total outstanding loan portfolio in the banking sector as a whole which has quadrupled in just 2 ½ years, measured at year-end 2009. As a consequence, indicators of financial intermediation have improved even if they are still low seen in international context, again measured at year-end 2009.

Table 6: Some key indicators on financial intermediation (by banks)

Indicator	2006	2009
M2 as % of GDP	20%	32%
Deposit as % of GDP	19%	26%
Loan as % of GDP	10%	19%
Loan as % of Deposit	53%	73%
KN as % of M2	42%	54%

Source: BOL, annual reports

125. **Banks involved in RMF provision.** Of all banks, only five are involved in service delivery to the RMF segment, three of which have RMF provision as their main or only focus and two of which have the stated objective of achieving sustainability.[134]

126. **Agricultural Promotion Bank (since 1993)**. APB has been established as a rural policy bank 18 years ago. APB's turn around to becoming an independent and sustainable commercial bank has only been ongoing for the last half decade and has been challenging. After years of being loss making the bank as a whole and each individual branch were suddenly faced with the requirement of profitability and at the same time faced competition from newly licensed private commercial banks. As policy lending and policy funding were said to be phased out a market share needed to be captured by providing financial services that meet the demands of customers and are competitively priced while remaining profitable. Staff needed to adapt a service and market-oriented attitude. Performance-based evaluation was introduced and showed the challenges APB had to deal with. A first staff assessment made under the ADB supported RFSDP made clear that the overall level of adequacy of existing staff was too low. APB was further handicapped by its old administrative MIS system, seriously hampering efficiency and the provision of relevant management information.

[134] Please note that no information on banks' loan and savings portfolios or on their involvement in providing money transfer and remittance services has been provided by BOL. As a consequence, the analysis is necessarily based on incomplete information.

In the meantime APB has stated its objective is to be the "premier provider of financial services in rural Lao PDR". Currently it is in a long process of building a CORE-based banking MIS and rolling it out over its network of branch offices.[135] Over the years it has build a large network all over the country consisting of 17 branch offices and 60 service units, the largest of all banks. APB has 915 staff of which 256 are credit officers. APB has a strategic focus on RMF service. It delivers financial services to the rural areas and a large part of its loan portfolio finances agricultural activities. Its main contribution in terms of products is in the delivery of savings, loans and money-transfer services within Laos.

Ultimo 2010 it had a total outstanding loan portfolio of $208 million, $37 million of which consisted of 9.054 group loans approximately 80,000 families which can be considered micro loans. The remaining $171 million was outstanding in a total number of 11,365 individual loans at an average size of $15,000.[136] Of the individual loans, a number of 5,815 or 51% are below $5,000 in a total amount of $15.5 million at an average of $2,670 per loan. Considering lending to the lower RMF segment only, APB serves about 86,000 families with a total loan portfolio of $52.5 million or 25% of its overall portfolio.

APB plays an important role in providing savings opportunities to the RMF segment as it has 75,000 accounts outstanding with less than KN10 million in savings, including time deposits. Below KN40 million, the number of accounts is 79,000 while the overall number of savers and time depositors is 125,000, indicative of the current relevance of "richer" customers in the providing APB's funding through deposits. APB provides quite a substantial number of money transfers within Laos, 400,000 per year or about 1,500 per working day at an average of $475 per transaction. As indicated by APB's management, the lack of a high-quality banking MIS system hinders the provision of fast, reliable information on APB activities, portfolio and results. The data of all branches and service units have to be collected and assembled, with resulting difficulties, time lags and risk of errors.

127. **Lao Development Bank (since 2002).** LDB is the result of a merger of seven former SOCBs made in two steps, the last one of which took place in 2002. Related to this origin, its client and loan portfolios and its staff are still largely the same as those of their predecessors. LDB deals with some similar issues as APB. It has a large network of branch offices, an old administrative MIS which is being replaced by a new CORE based system and it is in a turnaround to becoming a full-fledged commercial bank. Like APB, LDB has been instructed by the government through BOL to start doing loan assessment based on financial capacity and on the willingness to repay a loan. This instruction logically coincided with the explicit mandate and responsibility given to LDB by the government to be a main SME Bank. This instruction to create a state-owned SME Bank is based on the government policy on SME promotion and development and is embedded in a Prime Minister Decree.[137]

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[135] A Core Banking System is a back-end system that processes daily banking transactions and posts updates to accounts and other financial records. Core banking systems typically include deposit, loan and credit-processing capabilities, with interfaces to general ledger systems and reporting tools.

[136] Traditionally the average number of families per group loan is around 9.

[137] Decree on the Promotion and Development of Small and Medium Enterprises, 42/PMO, 20/04/2004.

Since LDB has increased the number of loan approvals and more attention has been given to assessing requests for smaller loans. In reality however, LDB is not yet a "real" SME Bank, as its customer base mainly consists of large companies and its loan portfolio consists of large loans. The reflection of this focus on large companies can be found in LDB's internal definition of a "small loan", which considers a loan of less than $600,000 to be small. Moreover, SMEs as defined in the prime minister decree constitute only a small number of companies, as it confines SMEs to formalized enterprises or to those enterprises that are "independent and are legally registered and operate according to the prevailing laws".[138] In effect, the definition excludes informal and household enterprises, and the informal economic activities that are often employed next to subsistence agriculture, which as we have seen are the main structures of operation for the large majority of people in Laos. As a consequence, SME development and efforts to enhance access to finance for SMEs currently have little actual scope in Laos. Again as a consequence of the definition of SMEs also LDB, apart from its focus on larger companies because of its pre-merger history, hardly has any position in financial service delivery to the 99% of all enterprises in Laos that are the group of household-based micro enterprises. On LDB's involvement in delivery of savings and money transfers no data were available for the purpose of this study.

Table 7: Definition of SMEs in the Lao PDR. [139]

Category	Average annual no. of employees	or total assets in kip	or annual turnover in kip
Small	≤19	≤250 million	≤400 million
Medium	≤99	≤1.2 billion	≤1 billion

128. **Nayoby Bank (since 2006).** The state-owned policy bank delivers loans with subsidized interest rates to families in the parts of the country with the highest poverty rates. Loans are delivered as group loans intended for (commercial) agricultural production to groups of 10 to 15 families up to a maximum amount of KN30 million per family.[140] Some 50% of NBB's loan portfolio consists of loans to companies outside those poorest areas that process or sell agricultural produce from families within the areas. NBB doesn't take deposits but is funded from the

[138] It is to a certain extent unclear what the exact meaning of the definition regarding registration and legality is. Strict interpretation would render the definition with little scope. Just to give an example, of all companies in Laos that need to use an (advanced) accounting system and be audited, less than 10% do so.

[139] No 42/PM, 20 April 2004: Article 2, Definition of Small and Medium Sized Enterprises:
Small and medium sized enterprises, or SMEs, are independent enterprises that are legally registered and operating according to the prevailing laws of the Lao PDR and are classified into the following size categories:

i. Small enterprises are those having an annual average number of employees not exceeding 19 persons or total assets not exceeding two hundred and fifty million kip or an annual turnover not exceeding four hundred million kip, and

ii. Medium sized enterprises are those having an annual average number of employees not exceeding 99 persons or total assets not exceeding one billion two hundred million kip or an annual turnover not exceeding one billion kip.

[140] The loans will carry three different interest rates: 7 percent for loans of one year, 8 percent for one to three years, and 10 percent for loans of more than three years.

government's budget through BOL. No information was available on money transfer facilities. At year-end 2009, NBB outstanding loan portfolio was about $75 million and had some of which 50% were long term loans (over three years), 20% mid term (between one and three years) and 30% short term. The number of loans outstanding to families in the identified districts with highest poverty rates has been estimated to be at least 52,000.[141]

129. **Phongsavanh Bank (since 2007).** Lao privately-owned Phongsavanh Bank (PSB) is part of the large multi-sector Phongsavanh group with commercial activities in industries such as timber, airline, international trading, hospitality, telecommunication and security. PSB has used an expanding network of branch offices (4), service units (15) and staff (350) including foreign and Lao experts, to support implementation of its strategy and serve large number of customers, including those in the lower segments of the financial services market. PSB uses CORE based MIS and commercially aggressive and innovative marketing methods, which have been particularly successful in attracting savings. In the meantime it has accumulated some 150,000 savings accounts in just 4 1/2 year. It has some 15,000 loans outstanding in a $60 million portfolio, of which some 10,000 loans are in amounts below KN20 million.[142] This has been the results of a product loosely translated called the "Easy-Money Loan" with monthly interest rates of between 1.25 and 1.5% and secured by a "salary guarantee". The product was aimed at serving civil servants and other salaried employees, a group which as we have seen earlier is a minority in Laos and which not necessarily consists of the typical customers that make up RMF's target group. As a consequence of disappointing results both in terms of revenue and in terms of repayment, PSB has decided not to further expand on lending to the lower segment as it has analyzed that within PSB the institutional capacity is not yet at required level.[143] It analyzed that for successful loan delivery to the lower segment credit officers need to receive training and get experience in accessing financial capacity of households and informal micro enterprises. As seen earlier, typically this information is lacking while and difficult to assess, with often many sources of income and types of expenditures and without a clear (possible) separation between private and business. This capacity is not enough present inside PSB and in training institutions in Laos, nor does PSB have an explicit and structured training and Human Resource Development (HDR) strategy to fill this void. Next to loan assessment capacity, the specific mechanisms needed to deliver financial services to RMF customers and the related required internal-control techniques are lacking. PSB however provides money transfers services and is a front runner in linking up with Thai banks, which could allow remittances from Thailand through Swift for PSB's customers.

130. **ACLEDA Bank Lao (since 2008).** Foreign privately-owned ACLEDA Bank Lao (ABL) is the daughter of the successful Cambodian RMF bank that started as a development project, in a country with many features similar to those of Laos. Other shareholders are the same as those that helped the development of ACLEDA in

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[141] Data based on various reports made in the Vientiane Times of interviews with NBB's senior management.

[142] Information supplied by PSB, 2011. PSB does not publish an annual report.

[143] In a recent newspaper article however re-introduction of the product was announced by PSB management.

Cambodia and which are long-term strategic partners. These shareholders have a socially responsible orientation and have worked with other microfinance organizations over the world for many years.[144] Currently, ABL is the largest and most respected RMF provider in Cambodia and has set a benchmark quality standard in service provision, staff training and ethical behavior. In Laos, ABL was the first bank to publish an annual report. It is also the only bank in Laos with full technical capacity, knowledge and experience in sustainable RMF service delivery based on 17 years worth of experience, learning and building in Cambodia. A key element of its strategy is formed by its staff selection and evaluation methodology, and the related structured training program. ABL has the mission to replicate ACLEDA's model in Laos with Lao staff and management. ABL provides loan, savings and money transfer services, and remittances through Swift are available. Ultimo 2010 both its loan and savings portfolio were in the amount of $20 million. Of the total number of almost 7,000, all individual loans, 5,500 or almost 80% were in amounts below $5,000 at an average $2,600 per loan. Over the whole year 2010 more than 16,000 payments were made within Laos through ABL.

Table 8: Loan portfolios of banks involved RMF segment, data 2009. [145]

Bank	# loans < $10,000	Portfolio < $10,000 (in $million)	Total number of loans	Total portfolio (in $million)	# loans < $10,000 as % of total	Loan portfolio < $10,000 as % of total
ABL	4,542	10	4,718	13	96%	77%
APB	95,000	94	100,000	127	95%	74%
LDB	6,949	29	10,498	243	66%	12%
NBB	> 52,000	43 [146]	na	75	na	na
PSB	12,500	20	13,200	55	94%	36%
Total	**171,000** [147]	**153**	**128,416** [148]	**438**		

Source: Interviews with representatives of the mentioned banks; Vientiane Times (NBB).

2.2.2 Non-bank financial institutions

131. **NBFIs' importance and role in RMF.** The combined group of non-bank financial institutions (NBFI) and insurance companies has traditionally played a

[144] Dutch Development Bank FMO and Dutch socially-responsible investment bank Triodos have in the meantime been joined by the International Finance Corporation.

[145] Information received from banks (not checked), data ultimo 2009. For APB, the numbers are approximate numbers. Moreover, for APB the data on number of loans and loan portfolio mentioned to be below $10,000 is in reality the number below $12,000 overestimating the real numbers slightly. APB portfolio consisted at the time of measurement of about 10,000 group loans with on average 9 families per group and just over 10,000 individual loans.

[146] Estimated minimum amount; the actual total loan portfolio of loans of less than $10,000 is expectedly higher.

[147] All five banks. Data Nayoby Bank inferred from Vientiane Times.

[148] Excluding borrowers from Nayoby Bank, the Policy Bank

minor role, owning a mere 2% of all assets in the financial sector. Still as seen earlier in table 5, since 2007 a rapid growth has taken place in the number of non-bank providers and in the number of outlets. Immediately below pawn shops, Lao Telecom and the LPFI are described because of their (potential) role in RMF provision, followed by MFIs and insurance providers.

132. **Pawn shops.** A prime-minister decree has regulated the creation of formal pawn shops since 2002.[149] The decree and follow-up BOL implementation notice have however not led to the development of a structure for supervision or any supervisory activities, despite the fact that a minimum of 28 pawn shops have been licensed by BOL of which 23 are still in operation.[150] Anecdotal evidence and preliminary findings of initial contacts established with pawn shops by FISD officers are that the rules embedded in the decree are sometimes not followed. Examples are the acceptance of land titles as pawn and charging interest rates at levels higher than allowed. Supervision could and should help protect clients, and prevent against the risk of money laundering, which are common risks associated with (unsupervised) pawn shops. Concrete data on the activities of pawn shops are not available, neither in existing financial sector studies nor with BOL. Pawn shops are a means of quickly, easily finding emergency cash at low-interest rates to deal with peak expenditures such as those caused by seasonality or unexpected events, both of which are important motives for RMF clients.

133. **Lao Telecom.** Lao Telecom is a main telecommunication provider in Laos and is owned for 51% by the government and for 49% by a Thai investment company. Lao Telecom has a 1,900 staff, 800 of which work in Vientiane and 1,100 of which work in the provinces. It has a large network of distribution centers (soon to be 52) and sales agents (over 2,000) all over the country. It customer base reached 1.5 million in 2010, or 25% of the population, with expected growth this year at 400,000 new customers.[151] Lao Telecom has received a license from BOL to provide money transfer services within Laos under the product name "M-Money", and late 2010 it has initiated a brief pilot. During the pilot it concluded it doesn't have the knowledge or institutional capacity to manage even basic aspects of starting operations as a financial service provider and halted the pilot.

134. **Risks of Lao Telecom's license and lack of supervision.** The license given to Lao Telecom for "M-Money" has no legal foundation in terms of a regulation since none exists and without restriction. For the FISD as currently responsible supervisors it is highly advisable to undertake quick action and open conversation with Lao Telecom on the development of "M-Money", in particular on the internal control measures to manage the intrinsic risks involved in handling mobile-phone based payments.[152] The current situation is risky for M-Money customers, agents, Lao Telecom itself as well as for the trust in the financial sector as a whole. In order to manage the risks, adequate measures should be taken. A regulatory setting and

[149] 10/PMO, 02/02/2002
[150] 01/BOL, 09/02/2003
[151] In 2009, Lao Telecom grew 45% of its customer base measured from year-end 2008.
[152] The FISD has been handed down the responsibility last year, when the former Bank and Financial Institutions Supervision Department split into a BSD (responsible for bank supervision) and a FISD (responsible for supervision of non-bank financial institutions). The former BFSD has issued the license.

supervisory regime could be created for providing mobile-phone based payment services, or the license given to Lao Telecom could describe what it is and what isn't allowed to do and what risk-management control measures should be taken. As has happened in Cambodia, in open communication between Lao Telecom and the FISD risks could be assessed, and a way forward could be sought in a joint effort. In any case, it seems necessary to create adequate internal control and other safety provisions, including those associated with working with a distribution network which mainly consists of agents. Safety measures are needed on the IT technical side and (internal) control measures are needed to manage the risks intrinsically involved in (large amounts of) money being handled as part of a primary process inside the Lao Telecom organization.

135. **Lao Telecom's potential importance in RMF provision.** The situation described above highlights the potential of having an eager provider, for which the costs of creating a network for its primary business activities have already been sunk and for which consequently providing financial services is a potential generator of additional revenues, through a network with ample outreach all over the country, including the rural, and even relatively remote areas. Laos in general has large and still strongly growing mobile-phone coverage, with 3.2 million subscribers at year-end 2009 up 66% from year-end 2008. Even with cautiously projected growth rates it is expected that coverage will reach close to 100% within the next years.

136. **Lao Postal Financial Institution (LPFI).** The LPFI is a more or less separately functioning part of the Lao Postal State Enterprise, often called "Enterprise des Postes Lao" or simply "EPL", the latter a state enterprise since 1986 and part of the Ministry of Post, Telecom and Communication. The LPFI started operations in 2000 after being granted a license to provide financial services by BOL. BOL has since been supervising the LPFI and does so currently through its FISD.[153]

137. **LPFI's unique position.** LPFI's license is an individual, special license and has not been based on any broader regulation. Indeed, the LPFI is the only one of its kind as postal financial institutions typically are. Some specifics regarding the role the LPFI is allowed to play in terms of financial service delivery are detailed in the Law on Postal Services. The Law allows postal financial services to be provided, in principle exclusively, by the Lao Postal State Enterprise which does so through the LPFI. It stipulates on postal financial services that:

- *"Postal financial services refers to services for issuing or paying money orders and postal checks; making money transfers and other payments of public utility bills through postal services; postal item insurance, postal savings services and the offering of loans to members (of the LPFI).*
- *Postal savings services and the offering of loans to depositors are required to follow the regulations of the Bank of the Lao PDR.*
- *Other financial services can be implemented based on the approval of the government".* [154] [155]

[153] 11/BOL, 16/11/2000

[154] Article 15, law on Postal Services (06/NA, 17/05/2004)

[155] Articles 10, law on Postal Services (06/NA, 17/05/2004). More on postal financial services can be found in articles 2, 7, 15 and 20.

138. **LPFI's outreach.** The LPFI has a branch office in each of all 17 provinces and uses an additional 125 service units of EPL as outlets for money transfers within the country. It has 45 staff, 20 of which work at head office in Vientiane and 25 spread out over the branches. It provides savings and loans services, with loans almost exclusively extended to civil servants and other salaried people up to a maximum of 70% of the official year salary. Its savings products are in principle available to all Lao people and borrowing can be done with savings as collateral. At the end of the 1st quarter of 2011, the LPFI had a total of 16,985 savings accounts with accumulated savings in the amount of $9 million at an average $530 per account and a number of 5,894 outstanding loans with a portfolio of $8.4 million or $1,400 per average loan. As mentioned earlier, LPFI facilitated 234,000 money transfers over 2010, or over 900 per working day.

139. **LPFI's potential importance in RMF provision.** Just like Lao Telecom, LPFI has the great benefit of a large network laid out for its primary business activity (postal service delivery) the costs of which are sunk. In other words, financial services create additional income at low, (almost exclusively) variable costs. As a consequence of the low cost structure, postal financial service providers have been successful in many countries in different parts of the world in reaching large numbers of low-income people with standard, quality, easily accessible, low-cost financial services, both in developed and in developing countries. Most postal financial service providers starting offering simple, standard savings and payment facilities. Those extending service provision by offering current accounts have become the largest financial institution in many countries in terms of number of accounts, with often the largest penetration in the market for low-income customers.[156] As a consequence the ability of reaching large numbers of people and the existing physical infrastructure (buildings, people, and an administration system), relatively little revenue per transaction is still enough to make financial service delivery a profitable activity for many postal enterprises in the world. Also the LPFI is a profit centre for EPL while it is only in the starting phase of utilizing its full potential.

140. **LPFI, Lao Postal Enterprise and the Universal Postal Union.** EPL has been a member of the Universal Postal Union (UPU) since 1952, which is currently supporting EPL in developing an overall strategy that includes the LPFI. [157] Generally, UPU works specifically towards stimulating financial inclusion of people in rural areas. Through UPU's support to EPL, LPFI receives some technical support. Currently LPFI is in the process of changing and developing its IT system which will facilitate the creation of giro accounts and in general will allow for the creation, the

[156] In China the postal financial institution managed 767 million giro accounts at year-end 2009; in the year 2005 a total of $65 billion was deposited in 189 million accounts. In India there were 174 million savings accounts with a total of $74 billion in savings, or an average of $425 per savings account, year-end 2008. In Viet Nam already 500,000 accounts had been opened in its Postal Financial Institution in 2005, only 6 years after starting operations, holding a total of $450 million in deposits at an average of $900 per account.

[157] UPU (established 1874, number of member countries 191) is the main, worldwide forum for cooperation between postal sector providers. It fulfils an advisory, mediating and liaison role, and provides technical assistance on postal service delivery, including on stimulating financial services volumes and quality.

management and the administration of financial products without depending on other financial service providers.[158]

141. **Formal Microfinance providers.** In this paragraph MFI refers to organizations that have been licensed by BOL and have been structured based on BOL issued MF regulations to take deposits, extend micro loans, provide payment services within Laos and sell insurance products as an agent.[159] BOL supervises the MFIs through monthly off-site analyses of reports sent by the MFIs and yearly on-site inspections.

142. **Licensed MFIs: DT MFIs and SCUs.** There are two main types of MFIs. Deposit-Taking MFIs (DT MFIs) are companies with legal personality owned by shareholders whose liability is limited to their share capital, that provide microfinance services to the broader public. Saving & Credit Unions (SCUs) are member based and provide services only within the member group. They depend on deposits from the public (DT MFIs) or their members (SCUs) for funding as only up to a maximum of 30% of the outstanding loan portfolio can be borrowed externally. The maximum loan amounts are almost completely limited to KN10 million as a minimum of 80% of the outstanding loan portfolio should consist of loans smaller than that amount. All existing MFIs operate in urban or semi-urban areas and their service provision is limited to short-term loans and savings products.[160] Since 2004, the number of formal MFIs has grown from only two to currently 24.[161] Below, in Table 8, some key data are shown.

143. **Non Deposit-Taking MFIs.** Next to a regulation enabling the establishment of MFIs licensed to take deposits and provide microfinance services, BOL has issued a regulation aimed at bringing all organizations which are extending microfinance loans under the jurisdiction of BOL. All those organizations should receive a certificate of registration from BOL and should also register with other parts of the government pertinent to that individual organization's situation. The purpose of the regulation is "harmonization of implementation and outlining measures of sustainability", as according to the regulation BOL should check the founding basis of the organizations (bylaws) and if the organization has actually registered with other parts of the government. The regulation also prescribes a specific chart of accounts allowing for comparability and assessment.

144. **NDT MFIs in practice.** In practice, only ten organizations so far have registered with BOL even though there are over 4,000 VMLFs and an unknown number of informal moneylenders and agents providing payment services. Moreover,

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[158] Advanced Programming Information System or APIS.

[159] Regulation for Savings and Credit Unions (No. 03/BOL, 03/06/2008 and regulation for Deposit-Taking MFIs (No. 04/BOL, 20/06/ 2008); the MF regulations have their origin in the Rural Finance Sector Development Program (RFSDP), supported by ADB, part of which aimed at creating an enabling environment for good practice, formal MFIs. After issuance of 1st pilot regulations for member-based providers in 2004 and for shareholder-based ones early 2005, the final versions were issued in June 2008.

[160] Only DT MFI Saynhai Samphanh offers loans with a duration of a year or more to a clientele consisting of teachers and civil servants.

[161] Two financial cooperatives already existing in 2004 were based on a BOL regulation for credit cooperatives issued in 1994.

three out of the ten that have registered are actually associations of VMLFs, functioning mainly as both Network Support Organization and APEX for donor funding, rather than as MFIs. The VMLFs that are members of the three (associations), not there associations, are responsible for two-thirds of the total of 6,300 loans extended by all Non-Deposit Taking MFIs (NDT MFIs) together in a total amount of $1.3 million. Since the main group the regulation is affecting is the group of VMLFs we will deal with issues related to NDT MFIs in paragraphs on VMLFs.

Table 9: Key data on licensed MF providers. [162]

	members	Savers	borrowers	loan portfolio	average loan amount
DT MFIs	na	9,744	5,959	$1,843,000	$310
SCUs	3,414	3,130	2,411	$2,084,000	$864
Total		**12,874**	**8,370**	**$3,927,000**	

Source: BOL FISD, 2011

145. **MFIs: low outreach and low capacity.** So far formal MFIs have not been very successful RMF providers. Despite the regulations being effective for seven (SCU) respectively six (DT MFI) years and despite ample technical and financial assistance from international development organizations, outreach in terms of number of borrowers and savers can be considered low just as institutional strength. Institutional assessments have shown lack of good governance practices, lack of demand orientation, of marketing ability and of assessment of customer satisfaction, high delinquency and write-off, weak credit assessment, high key-person risk, low efficiency and management skills, weak “accounting” skills leading to incidents of overstating income, weak internal as well as external control and a general inability to deliver financial reports.[163] Indicative is that minimum and maximum values of key ratios that indicate financial health that are embedded in the MF regulations are not met by most MFIs.[164]

146. **Two largest MFIs: no RMF clients, high interest due to inefficiency.** Of the two most successful formal MFIs in terms of outreach and institutional capacity (which together are responsible for over 60% of the number of loans delivered by all licensed MFIs), one delivers services exclusively to civil servants (which is not the intended RMF target group) while the other has designed loan products with a total interest rate and cost structure creating a Annual Percentage Rate (APR) of between

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[162] Source BOL, 2011. The table is based on data that were available to BOL’s FISD. As the FISD does not regularly receives data from many formal MFIs, despite a regulatory obligation for DT MFIs and SCUs to report monthly, the information shown slightly underestimates the true numbers.

[163] ADB RFSDP (three SCUs Vientiane, Luang Phrabang and Seno for a year); Rabobank Foundation (five SCUs in Luang Phrabang, Seno, Savannakhet (two) and Thakhek for three years); Savings Bank Foundation for International Cooperation (DT MFI Ekphatanna) for two years; CARD MRI (DT MFI Ekphattana) for two years; German Cooperative and Raiffeisen Confederation (RDC Naxaythong; Fonds Cooperatif; CCSP) and last but not least; ADB “Catalyzing MF for the Poor” (all 12 licensed MFIs and SCUs at the time) for three years.

[164] Source: institutional assessment ADB “Catalyzing MF for the Poor Project” (JFPR 9095), 2010/2011.

95% and 105%. In terms of savings, the same two MFIs hardly play a role in providing services to RMF customers. They mainly find funding through deposits made by a small number of shareholders, and individuals and businesses within the shareholders' network, depositing large amounts (up to tens of thousands of $) at a time, and to a lesser extent through compulsory savings as part of loan agreements. They do not play a role in providing payment services, nor are they suited to fulfill this role lacking IT facilities and network of outlets. They also do not sell insurance even though this seems feasible.

2.2.3 Insurance

147. **Private insurance.** Over the last 4 years the number of private-insurance companies has risen from one to six. The largest, Allianz General Laos (AGL) until recently had market share of 85%. Within the group of new market entries are companies with ambitious targets for market penetration, including two joint ventures in which SOCBs BCEL respectively LDB have a share. Of all six companies, five are a joint venture of an international private insurance company with a Lao government counterpart.

148. **Current size private-insurance market.** The private-insurance market is very small in Laos, with only $2.3 in total premium income per capita in 2009. Private insurance is also highly concentrated, in non-life insurance; of total premium income in 2009, only 2% was for life insurance, 5% for personal accident and health insurance, and 92% for other non-life insurance. The bulk of insurance premium is paid for by companies and only some high-income individuals (car owners), despite individual health, life and accident insurance being available. By those who can afford it, health insurance (with combined life insurance) is often bought in Thailand from insurance companies incorporated there, which covers health care expenses made in Thai hospitals which are often preferred over those in Laos (similar: Lord 2010).

149. **Current role in and demand from RMF segment.** Private insurance hardly plays a role, if any at all, in service delivery to the RMF segment. Insurance companies observe demand to be low and potential distribution channels (e.g. banks) to be lacking openness to cooperate or communicate on potential mutually beneficial cooperation for example in the form of cross-selling. Despite third-party liability insurance being compulsory for cars and motorbikes, only an estimated 50% of all car owners and 5% of all motorbike owners have taken out insurance. Distribution to private individual clients takes largely place through networks of agents.

150. **Social insurance.** Currently three different social-insurance systems can be distinguished in Laos. Two are more formal and offer combination of insurance of health care and social security on a compulsory basis to salaried staff of the government (State Authority for Social Security) and private companies (the Social Security Organization). A third offers insurance (only) of health care to the informal sector, or in other words to those that do not have a position as salaried employee formalized by a labor contract. The latter system of Community-Based Health Insurance (CNHI) is voluntary and paid for by member contributions. In order to help low-income and poor people gain access to health care, a fund has been created to

pay the contributions to the CBHI for its poor members. This so-called Health Equity Fund in effect forms a buffer between the clients and the CBHI, and creates the necessary security of funding for the health care provider. Recent data issued by the MLSW (2011) indicate that 11.7% of the Lao population is covered for health care expenses in all schemes together.

151. **Social Security Organization**. The Social Security Organization (SSO) offers a comprehensive social-insurance package to salaried staff of private companies. For companies with over nine staff membership of SSO is compulsory; smaller companies can become a member and insure their staff on a voluntary basis.

152. **Low rate of participation in SSO.** Currently only 708 private enterprises, out of a total of between 3,033 and 4,899 companies that employ 10 or more staff have joined the SSO. There is a total number of 53,000 contributing staff and, including dependent family members, 110,000 insured people. The number of companies that have joined SSO is steadily rising but is only a small percentage of the total number of companies formally obliged to join, despite the fact that obligation has been in existence for over 10 years.

Table 10: Social Insurance in Laos

Table 1: Four social health protection systems

	SASS	SSO	CBHI	HEFs
Target population	Civil servants and their dependents	Private-sector salaried workers and their dependents	Self-employed and informal-economy population	Families identified as below the poverty line
Estimated no. of persons in target population	800,000	200,000	3,500,000 (including about 1,500,000 near-poor)	1,500,000
Dependency ratio	2.7	2.1	4.2	4.2
Legislative tool	Decree 70 (2006)	Decree 207 (2001)	Regulations, Decree pending	MOH Regulations
Implementation date	2006	2002	2002	2004
Ministerial authority	MOLSW	MOLSW	MOH	MOH
Current scope of operations	All provinces	Vientiane Capital and 3 provinces	18 sites in Vientiane Capital and 8 provinces	Selected provinces
Contributions for health care	4 per cent of salary shared by employer and worker	2.2 per cent of salary Shared by employer and worker	Flat amount by family size, with urban and rural rates	Same as CBHI where merged, amount spent varies by HEF
Health-care delivery	Contracts with providers; capitation and reimbursement	Contracts with providers; capitation with adjustment	Contracts with providers; capitation based on contributions	Capitation through CBHI for some, reimbursement by fee-for-service for others
Insured persons (August 2009)	300,000	85,000	65,000	15,000

Source: www.issa.int (consulted August 2011, data 2009).[165]

[165] Contrary to what is mentioned in this oversight, we understand all civil servants are covered (the 6th NSEDP 2006-2010, page 42). We have not been able to verify.

153. **SSO: Extensive coverage.** Coverage provided by the SSO is extensive and includes funeral benefits, medical care, sickness benefit (in case of temporary loss of working capacity), maternity benefit, employment injury and occupational diseases benefit and invalidity benefit (including coverage of loss of working ability, retirement pension and survivors' benefit). There are plans to extent coverage to child allowances and unemployment benefit.

2.3 Semi-formal providers

154. **Background.** Semi-formal providers have traditionally played an important role in RMF provision and were present in large numbers before the issuance of the current MF regulations. Their development started with in-kind revolving funds in the form of rice banks and livestock banks, which were later extended to include revolving credit funds. They had been introduced in the late eighties of the previous century mainly through the Lao Women's Union (LWU), one the four mass organizations. In the late nineties mobilization of deposits was made a target and the inclusion of "savings" in the LWU model was the next innovation. At the time when the "credit cooperatives" were introduced in the Lao PDR its basic model was adapted to fit the Lao setting. The principles of internal democracy, self help and self determination normally found in cooperatives have been modified to match democratic centralism, the principle at the foundation of the political organizational structure of the Lao PDR, by adding a compulsory "advisory committee" of representatives of LPRP, mass organizations and security forces next to an elected village-based management committee.[166] [167]

155. **Initially: in-kind food assistance followed by donor-funded, subsidized credit.** The initial revolving funds aimed fully at achieving social goals and were funded by grants. Typically, the projects would include a credit component at subsidized rates to fuel the projects outcomes, would be delivered to the poorest areas and funded by international development organizations. The blueprint for this type of delivery was seen as an added element to food assistance and aimed to stimulate production and thus enhance food security. This system was later disseminated to provinces, districts and villages all over Laos in the form of guidelines, through various parts of mass organizations and government, and was embedded in main policy and strategy documents on social-economic development. The resulting credit components or village revolving-loan funds (VRLFs) have been used in many rural development programs by different international development organizations (e.g. ADB, Lux Development, GIZ, International Labor Organization, IFAD, World Vision, World Bank) and Lao counterparts (e.g. LWU, LFNC, MAF, Department of Planning & Investment) and significantly also in social programs designed to compensate villagers that have been affected by hydropower or mining projects.

156. **Next step: savings mobilization.** The VRLF model that had by then developed was later extended to include savings and led to the creation of village

[166] Article 1, the Constitution of the Lao PDR.

[167] In Laos, the power of the population to be the master its own country is exercised and ensured through the functioning of the political system with the LPRP as its leading nucleus, article 3 of the Constitution of the Lao PDR.

savings and loan funds (VSLFs). The VSLFs built on the idea to mobilize savings hidden under mattresses in the (rural) population and make these funds bare fruit by mediating them to fund productive opportunities, which is of course a main function of any financial sector.[168] The initial VSLFs based funding completely on member contributions and received intensive, long-term TA. The latter two characteristics are important, as they have been observed to be positively correlated to success rate of VMLFs and without the presence of which most have been observed to fail, both in Laos as elsewhere.[169]

157. **Village-managed loan funds: different names and qualities.** In Laos, a whole variety of names is used to describe village-managed loan funds or VMLFs. For the purpose of this report we will use "village savings and loan fund" or VSLF for those VMLFs in which funding is mainly based on member contributions; village revolving-loan funds (VRLF) for those funded mainly by donors; and village-managed loan funds (VMLF) as overall description, irrespective of the funding base.[170]

158. **Impressive outreach.** As a consequence of political support by influential mass organizations and by different parts of the government, combined with a large number of donors eager to support rural development and disburse ample funds, VMLFs have achieved impressive outreach. In 2009 a VMLF had been established in 4,114 villages or in almost 50% of the total number of 8,704 villages. Membership amounted to a total of 366,000 villagers. Of all members, 173,000 had taken out a loan at an average of KN2 million, making for a total outstanding credit amount of $31 million. The opportunity to "save" was offered in 75% of all VMLFs and 328,000 villagers actually deposited or rather, made "member contributions". The word "member contributions" rather than "savings" is used on purpose. In VSLFs the reward on funds deposited, or "member contributions", is based on the VSLF's profit (dividend), the funds can not immediately or easily be withdrawn and no distinction is made between compulsory member contributions made on a monthly basis and the ones made voluntarily. The average outstanding member stake is KN823,000 making a total of $34 million overall. On average, dividend amounted roughly to 13% of average outstanding amount of "member contributions".[171]

159. **Outreach large but: different designs and different levels of institutional capacity.** These most recent data on outreach by VMLFs have been assembled by the National Economic Research Institute, on the request of BOL. The objective of the survey to give overall statistics has been achieved and a good set of data has been collected and aggregated. For the future, additional research into the relative strength of the various funds, their methodologies and achieved outcomes is suggested here, and should include reflection on the partners that have been involved in their set up.

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[168] Worded by HE Mr Xaysomphone Phomvihane in 1996, at that time Minister of Finance.

[169] J. Murray and R. Rosenberg. 2006. Community-Managed Loan Funds: Which Ones Work? Focus Note No. 36. May 2006. Washington, DC: Consultative Group to Assist the Poor.

[170] The many different expressions used can cause confusion when discussing them, as many have similar structures despite their different names. Confusion is added as different people have different ideas or definitions for the same expression, making it necessary to clarify beforehand to avoid confusion.

[171] "Microfinance Statistics for the Lao PDR: 2009" April 2011, National Economic Research Institute, Ministry of Planning and Investment

The concept of VMLFs encompasses both VSLFs and VRLFs, and within both groups different key features and indicators of quality can be found when observing from a perspective of "sustainable RMF" provision.

160. **Core group of village-managed savings and loan funds.** Three main programs are known in which the factors of success mentioned earlier have largely been present. These programs have resulted in a core group of VSLFs with a strong sense of ownership within both villagers and authorities, about which relatively adequate data and information are regularly collected by the organizations themselves. This core group of VSLFs is relatively strong and successful, has created bottom-up network support organizations to provide ongoing necessary TA and has developed demand-oriented products, such as emergency loans, loans with flexible repayment of principal and funeral insurance.

161. **Core groups' programs and key data.** The programs involve cooperation of the LWU with two different Thai organizations specialized in village-based development and VMLFs, and cooperation between LWU, MLSW and ILO. [172] The village-based model introduced by the Thai organizations is also used on a large scale in the North-East of Thailand, an area often called Lao Isaan and which has strong historical ties and cultural similarities with Laos. The combined group of VSLFs created in these programs:

- Operate mainly in semi-urban areas and rural areas with roads or market access in Vientiane Capital, Vientiane Province, Savannakhet, Khammouane and Champassak, and have extensive coverage there; e.g. over 91% of all villages in Vientiane Capital were covered by LWU-CODI and LWU-FIAM cooperation alone in 2009
- Have reached about 17% of all villages reached by VMLFs, or 8% of all villages in Laos
- Account for 56% of overall member contributions accumulated in all VSLFs together, or a total amount of $19 million
- Account for 42% of the total number of "savers" in all VSLFs, or 137,000 people
- Account for about 67% of the total loan portfolio in all VMLFs, or over $20 million
- Have provided 25% of all loans extended through VMLFs, or a number of 43,000 loans

[172] Community Organizational Development Institute (Thai government) and Foundation for Integrated Agricultural and Environmental Management (Thai NGO).

2.4 Summary

2.4.1 Information and transparency

162. **Information and transparency.** Transparency and information on RMF providers and RM provision are lacking, and this hinders RMF development.

2.4.2 Products

163. **Private insurance.** Despite the fact that there is a large need for tools enabling risk management, the market for private insurance in the RMF segment is virtually absent. Alternative methodologies to cope with risk are used, amongst which prominently saving and emergency borrowing. As ways to deal with agricultural risk in case of natural disasters (e.g. flooding) loans of state-owned banks are rescheduled and tax exemptions are provided, the eligibility for both of which is determined in cooperation with the government based on location, and emergency relief funds are raised through instant charity initiatives.

164. **Social insurance.** Social insurance systems are in place yet in early stages of development. The risk of having to make high and unexpected expenses for basic health care and hospitalization is covered through three main government-organized systems, together currently reaching about 11% of the population. Two of those systems cover a much broader spectrum of risks, including identified main idiosyncratic risks affecting lower-income households. These two systems however only insure salaried staff of the government and larger private companies. Outreach in health insurance to the main group of RMF customers is still very limited, reaching only an approximate number of 80,000 people on a target group of some 4 million, or about 2% of the target group.

165. **Savings.** As a consequence of the entry of commercial banks, outreach in terms of the number of savings accounts and the total amount of savings has grown. Banks are a main supplier of savings services in Laos. Currently, PSB and APB together hold over 275,000 savings accounts (including time deposits) of which APB alone holds 75,000 accounts in amounts of less than KN10 million, suggesting to be accounts of lower income people. The LPFI has 17,000 savings accounts, mainly of civil servants, while all MFIs licensed to take deposits combined service 13,000 savers. Interestingly, the semi-formal VMLFs together have provided 328,000 "savings" accounts in which savings have accumulated in the total amount of $35 million. However, in fact these accounts hold contributions made by members in VSLFs which can not be fully characterized as real "savings", as they are risk-baring, receive a profit-related reward (dividend) and can not (easily, quickly or sometimes at all) be withdrawn. Still, for many clients the contributions will be experienced as form of "savings" and will function as such. Compared to "real" savings, the contributions lack three main features; certainty of reward, liquidity and the flexibility to use savings for various purposes at the will of the saver. In the VSLFs this is compensated for by flexible and complementary loan products that be used for different purposes, can easily be taken out and have flexible repayment.

166. **Money transfers**. Looking at money transfers inside Laos, only banks and the LPFI are involved in the provision of these services. For the RMF segment, those institutions with large outreach, located close to customers, using flexible administrative procedures in particular with regard to identification, and with a low cost structure qualify as main possible supplier. This certainly includes APB, the LPFI, LDB, and for the future ABL and PSB. Depending on the way it manages to make use of its license Lao Telecom could become an important provider. Money transfers within Laos are offered at low costs and with flexibility, yet without the use of giro, payment or current accounts. Transfers are, in other words, cash-to-cash. VMLFs and formal MFIs are not involved in the provision of payment services. Regarding remittances from Thailand, the financial sector currently plays a very minor role, and leaves a large and potentially profitable market untapped.

167. **Loans.** Flexible, multi-purpose lending is mainly found in the core group of known quality VSLFs. Some SCUs also offer emergency loans and flexible repayment. Looking at loans for productive purposes, the largest providers in terms of number of loans to the RMF segment are found in the group of VMLFs as well, followed by banks. Licensed MFIs play a minor role.

2.4.3 Providers

168. **Commercial banks** play an important role in RMF service delivery. For the future, their contribution in terms of large-scale, sustainable RMF provision in Laos has much if not most potential for a number of reasons:

- Banks have the scale of operations (outreach in terms of service units, staff and number of customers) and financial strength that allow for economies of scale and of scope, for the import of high quality MIS and of TA, which together enable higher-quality, lower-cost service provision if compared to other providers.
- A number of banks is already engaged in RMF service delivery and has RMF service delivery as its main objective. Some have the knowledge, experience and methods to successfully engage in RMF service delivery and one is an acknowledged successful provider in a country with similar features.
- Banks are able to provide a broad range of needed RMF services including savings, loans, national and international payment services, and in the future could cross-sell insurance services.
- The ability to expand the provision of health insurance and private insurance depends on the availability of easy-to-use, low-cost payment mechanisms capable of reaching large numbers of customers. Banks' prominent position in the provision of payment services makes them well positioned to enable outreach in those insurance services.
- Because of their superior MIS and IT systems, at least for those banks that indeed have a well-designed, quality CORE banking system, banks have the potential to leverage on this IT capacity by extending services such as mobile-phone and POS-supported payment mechanisms.
- Because of banks' larger scale of operation, specialization can take place and appropriate internal control mechanisms can be designed. On the foundation of this organizational structure, at least for those banks that meet this description, it is

possible to leverage by using agents and large scale cross-selling of other financial products is possible.

- The number of banks has increased sharply while simultaneously the obligatory registered and paid-up capital for banks has been increased by $25 million per bank. Banks face commercial pressure to use these extra funds in a profitable way as idle funds are costly. Considering the fact that the number of larger companies and high net-present value customers is limited this normally would constitute a push factor for banks to go down the scale, and reach out for lower-income customers and smaller enterprises.
- Because of the geographical spread of their activities banks are able to diversify away covariance risk, something not available to localized RMF providers.

169. **Semi-formal, village-based providers.** VMLFs have large outreach and are supported by the powerful, extensive networks of mass organizations and the government. Within the group of VMLFs, a key group of VSLFs have been relatively successful in providing demand-oriented RMF services (productive loans, emergency loans, “savings” and funeral insurance) to large numbers of people over longer periods of time. A much larger group of VRLFs have mainly been serving as a distribution channel for cheap, donor driven credit and were often dissolved after project completion. Still, even the stronger VSLFs have limitations in terms of the quality of their services and their management capacity, and significantly in terms of becoming part of a more permanent financial infrastructure. Payment services can not be provided. Because financial intermediation takes place within the village, covariance risk can not be diversified away and a funding surplus or shortage can not be intermediated with other villages. For this, solutions are needed in terms of an organizational structure that accommodates the current political, institutional and organizational realities, is able to deliver TA, provide informal self regulation and supervision, and can intermediate funds between villages or with the formal sector.

170. The **LPFI** has potential of creating outreach and providing inexpensive, basic, accessible payment and savings facilities. LPFIs currently available money transfer services within Laos could in the future be extended with international remittance facilities. Payment facilities meet a need in itself, as large numbers of low-income households need to send and receive funds. Payment facilities however are also able to support outreach and increase the quality of the delivery of credit, savings and insurance products.

171. **Lao Telecom (and other telecommunication companies).** What is true for the LPFI is true for Lao Telecom and in the future possibly for other telecommunication providers as well.[173] Lao Telecom could leverage on existing financial sector infrastructure by enabling connectivity between banks which would greatly extend outreach of the financial sector because of the inclusion of its networks of branch offices and agents. Alternatively Lao Telecom could function as a stand-alone provider of small payments for which however it would need ample TA.

172. **Formal MFIs.** For formal MFIs that have been licensed to take deposits, both member and shareholder based, so far success has been limited due to various causes.

[173] Tigo in particular has explored the possiblity of being engaged in the provision of mobile-phone based payments yet was not able to find regulatory clarity.

They operate as purely private organizations and experience competition from the omni-present VMLFs, which have the support of government agencies and mass organizations including the local authorities, and have the confidence of villagers. Local authorities have been mobilized by the organizations they represent and also have a financial interest in the VMLFs. The result of these circumstances combined is a challenging market situation for MFIs. For MFIs, the lack of scale, capacity and TA combined with regulatory and MIS requirements weighs heavy. VMLFs do not have to meet these requirements nor are they taxed while banks operated on much larger scale. In a handful of cases, VMLFs have transformed into formal SCUs. Interestingly, the governance structure typical in VMLFs is in those cases often continued in the SCU and overrides the formal organizational structures of the SCU. For DT MFIs, the minimal capital requirements are too high for all but a few rich, well educated Lao people, whose interests in the organization sometimes override those of their less well-off customers. For both DT MFIs and SCUs, capacity requirements following from the DT MFI and SCU structures are hard to meet. TA facilities are lacking but so far even when provided progress has been slow but for the exception of two MFIs.

C. Assessment of Constraints and Development Issues

1. Introduction to RMF policy framework

1.1 Background: A short history[174]

173. **The start: New Economic Mechanism.** At the 4th National Congress of the Lao People's Revolutionary Party in 1986 the long-term foundation for the Lao PDR's economic structure was laid and was named "New Economic Mechanism" (NEM).[175] Until then both the economy and the financial sector were fully centrally managed. Two newly introduced features describe the essence of NEM, the first of which is embedded in the Constitution: *"All types of enterprises are equal before the laws and operate according to the principle of the market economy, competing and cooperating with each other to expand production and business while managed by the State in the direction of socialism"*.[176] The second feature was explained by President Kaysone Phomvihane when he stated that enterprises should *"make accurate calculations of their production costs and obtain profits for enlarged re-production"*.[177] [178] [179] The introduction of NEM was the first step on the way to improve macroeconomic conditions and the regulatory setting of the Lao PDR, and since has brought impressive economic development in terms of GDP growth.

174. **NEM and the financial sector.**[180] For the financial sector**,** NEM brought change of the existing banking system from a situation in which all financial sector functions were encompassed in a single government agency called the "State Bank" to a two-tier structure, a process that started in the year 1988. The State Bank and its portfolio of functions were formally split. The State Bank's branches were made responsible for client contact and loan disbursal while the State Bank's head office was turned into the Central Bank and named "Bank of Lao PDR". This split was the first step on a long road towards creation of a modern banking system, the first phase of which culminated in the year 2000 with the issuance of the PMO Decree on BOL.[181] Until then, the State Bank and its predecessors had a monopoly on banking

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[174] The short historical introduction in economical and, in particular, financial sector development is given to enable better understanding of current issues determining RMF development.

[175] Indicative of the importance of NEM for the LPRP, the Lao Government and for the socio-economic development of the Lao PDR, the Law on Election of Members of the National Assembly stipulates that a candidate "…must be loyal to the New Economic Mechanism of the Party…", Article 8 of the Law on election of members of the National Assembly.

[176] Article 13 Constitution of the Lao PDR

[177] In 1986 H.E. Mr Kaysone Phomvihane was the LPRP's Secretary General and Prime Minister, and he is generally considered to be the father of NEM.

[178] Quoted in "Buddhist Kingdom, Marxist State: the making of Modern Laos", page 265. Martin Stuart-Fox, 2002, 2nd edition. Studies in Asian History No. 2, White Lotus Press.

[179] A LPRP resolution of January 1988 on NEM advocated "equal treatment of the public and private economic sectors in commercial relations and in the law", "Lao-style New Economic Mechanism", by Chanthavong Saignasith in "Laos' dilemmas and options: the challenge of economic transition in the 1990s", page 25. Institute of South East Asian Studies, 1997.

[180] "Background and Evolution of the Bank of Lao PDR since its establishment to date: On the occasion of the Bank festive 35th founding anniversary 07/10/1968 - 07/10/2003", by Viengthong Keomanisy, Bank of Lao PDR.

[181] Based on government decision (11/COM, 12/03/1988), further enhanced in the Law on BOL (05/NA, 14/10/1995) and detailed in the PMO Decree on BOL (40/PMO, 06/04/2000).

and as mentioned, combined various functions in one entity. It disbursed funds in the form of loans to State enterprises and agricultural activities following central planning without calculation of costs and revenues, and in effect often on subsidized basis. Losses were paid for from the State budget while funding was found in printing money and to some extent in taking deposits. The State Bank was responsible for organization, staffing, budgeting, finance and salaries in effect of the whole banking sector.

175. **Rural and microfinance.** Following NEM, Laos opened up for international organizations. Development programs were initiated targeted at food security in the form of village revolving rice banks, to a lesser extent in the form of livestock banks and later often with a monetary credit component. The programs were mainly implemented through the LWU, MAF and MLSW. The rice, livestock and money that funded the village funds were granted by the development organizations and aimed to create food security and stimulate production. They were set up without enough consideration for institutionalization or sustainability, and although they were intended to revolve, soon dissolved or "revolved-to-zero". In 1996 some 1,650 of these village funds were identified, covering about 15% of the country's villages (Slover 1997). As food production needed continued stimulation and available donor funding needed a distribution channel, ABP was established in 1993 to function as an agricultural policy bank funded from the State's budget, donors and deposits**.** The first RMF development project that focused on demand, institutionalization and sustainability was jointly initiated by UNCDF and MOF in 1996. The project organized Microfinance Round Table meetings to introduce concepts such as sustainability, demand orientation, management autonomy, capacity building and "Good Practice" to a broad audience of senior government officials and policy makers. Another added element was the relevance of the absorption of rural savings as an objective of RMF development, which was emphasized in a speech held by the Minister of Finance.[182] Soon after APB was given the authority to collect rural savings and the first project that focusing on savings mobilization involving VMLFs was initiated by the LWU and FIAM.

176. **Further development until present.** Following the year 2000, ADB initiated two main financial-sector restructuring programs and in 2003 the Policy Statement was issued. Following 2007 rapid development took place as a result of the issuance of the Law on Foreign Investment, the renewal of the Banking Law and the issuance of Microfinance regulations. Since a large number of new, private financial institutions, banks, leasing companies, insurance companies and MFIs were established.

177. **Observation banking sector.** BOL has made progress from being the management at head office of the State Bank to becoming a Central Bank, introducing and developing its supervision function. Until the recent entrance of a large number of private banks though, BOL responsibilities to provide a level playing field and to supervise were less pronounced as the financial sector mainly comprised

[182] H.E. Mr Xaysomphone Phomvihane: "We will suggest ways to mobilize savings that are hidden under people's assets, especially in rural areas (…) I would like to propose (..) to concentrate on finding ways and methodologies based on our own sectoral experiences so that savings can be mobilized from the population, and to formulate strategies, forms and institutions that would circulate these capital funds to the rural population".

SOCBs with which a close relationship continued.[183] Despite formal separation BOL still maintained functions it had historically exercised, such as direct lending to the economy, managing state-owned banks by making decisions on issues such as staffing, products, volumes, pricing and target markets, and directly influencing interest rates for the sector as a whole.

178. **Observation RMF.** Historically RMF has typically been implemented as small, targeted and subsidized loans to create food security, without consideration for sustainability and intuition building, funded by donors and the state budget, delivered through VRLFs and a Policy bank. In the past, RMF has been mainly outside of the scope of BOL and was seen as the prerogative of LWU, MAF and MLSW except for BOL's role in steering policy banks.

179. **Relevance for identified constraints.** The historical background serves to help understanding of the (origin of the) current RMF development issues, the fact that development is a process, to acknowledge the progress that has been made and to show the dynamics that demand further steps to be taken.

1.2 Position of BOL and other agencies

180. **BOL and its multi functionality.** Having added the important role as financial regulator and supervisor BOL still has important roles as being executive-government's arm in the financial sector, as the actual managing director of state-owned banks and as direct lender to the economy, all of which find their origin in its days as head office of the State Bank and today still can be found acknowledged in the NSEDP.[184] The different roles given to BOL put BOL in an ambiguous and sometimes difficult position as the corresponding responsibilities can be incompatible.

181. **Little support for BOL as sole government agency responsible for RMF: need for coordination.** The decision made in the year 2007 to allocate the responsibility for RMF development solely to BOL caused an abrupt change in the method of operation and affected the powerful authorities that traditionally had been involved in what they saw to be RMF development. Perhaps logically, the main result from a survey held during the Lao National Microfinance Congress in 2007 was that only 9% of delegates agreed with BOL as proposed single government agency to be responsible for "*(consistency in) MF policy and regulatory approaches, problem solving, provision and dissemination of information and data*".[185] The survey was

[183] As embedded in NEM and found e.g. in the Law on Commercial Banks, article 6: "The State uniformly regulates commercial banks based on laws and regulations and the State protects the rights and legitimate benefits of commercial banks".
[184] Examples are found in BOL instructing APB and LDB to start cash flow based lending, prescribing product details for SOCBs and having to approve commercial details beyond prudential supervision, instructing interest rates to be used by APB, determine interest maxima for banks that want to borrow externally, giving targets for lending, make staffing decisions (senior management goes back and forth between BOL and SOCBs), lending to decentral authorities and companies, and policy lending through NBB (the Board of Directors of which consists of BOL senior management) etc.
[185] "Microfinance for the Poor in the Lao PDR: second National Conference Report", March 2007. Microfinance Capacity Building and Research Project, NERI (MPI) and Concern Worldwide.

held during a MF forum under over 300 stakeholders present, including representatives of various mass organizations, government agencies, development organizations working on MF and practitioners. A majority of delegates requested for additional coordination either by reinstating a dissolved special government RMF committee, which used to consist of representatives of the main authorities involved in RMF development or through formal cooperation between BOL and MPI (NERI).

182. **Too many policy makers, authorities and donors lack understanding of the concept of demand-driven, sustainable RMF.** Another observation could perhaps also be expected in the light of history. Over many years RMF had been seen to be small and subsidized loans, directed and targeted to secure food production and stimulate production, delivered through VRLFs and policy banks. Only in the year 2003 were concepts such as "sustainability" and "institution building" formally introduced in the Policy Statement. Still in 2007 the observation was made that the biggest constraint at macro level for development of a sustainable RMF sector is the fact that "*Some policy makers, authorities and donors still lack a solid understanding of sustainable market-oriented RMF. The concept of (building) sustainable microfinance (sectors) is not fully disseminated"*. The observation was a main finding of a joint UNCDF-GIZ stakeholder workshop with all main RMF stakeholders present, including representatives of various mass organizations and government agencies.

1.3 Policy documents

183. **RMF policy documents.** Statements on RMF policies can be found spread out over several policy and strategy documents. In the Lao PDR, the overall leading policy document on socio-economic development is the NSEDP and it contains ample reference to RMF. Main secondary documents are the Policy Statement, the Financial Institution Development Strategy of Lao PDR 2009-2020 (FIDS-2020), various guidelines on VMLFs issued by mass organizations and government organizations, and the Prime Minister Decree on SME Promotion and Development.[186] [187] For the insurance sector, next to statements on both private and social insurance in the NSEDP, no explicit policy document has been identified. A presentation by the Deputy Director of the Fiscal Policy Department of MOF combined with an interview of the Fiscal Policies Department directly responsible ASEAN division has given some clarity on policy directions for the purpose of this report. [188] Main policy objectives regarding social insurance have been found in a reference made to the National Health Development Plan until 2010.[189] Immediately

[186] No. 42/PMO, 20/04/2004

[187] Including which significantly the PMO guidelines for compensation of villagers whose livelihood has been negatively impacted by a hydropower or mining project.

[188] Mr. Bounthom Lomany, Deputy Director General of the Fiscal Policy Department, Ministry of Finance during the Multi-Year Expert Meeting on Services, Development and Trade, Geneva, 17-19 March 2009, in the setting of the United Nations Conference on Trade and Development: "The Regulatory and Institutional Dimension: Country Rapport Lao PDR".

[189] Mr. Padeumphone Sonthany, Deputy-Director General Social Security Organization, Ministry of Labor and Social Welfare. "Country paper: Social Security in the Lao PDR". ILO Series: Social Security Extension Initiatives in East Asia; Lao PDR Social Security.

below we will detail main parts on RMF related issues of the most relevant documents. The FIDS-2020 will be elaborated on in chapter III.

1.3.1 7th NSEDP 2011-2015

184. **The 7th NSEDP (2011-2015) on RMF.** Of the 7th NSEDP only the general Directives and Tasks have been communicated but plans in details have not yet been completed.[190] [191] Some specifics are however mentioned, such as that the expansion of VSLFs and VRLFs, and the expansion of the social-insurance system are considered achievements. For the future the 7th NSEDP wants the expansion of micro credit and adequate loans to SMEs. In order to achieve this, effort will be made to improve banking regulations and supervision of financial institutions. Elsewhere in the 7th NSEDP a broader scope is used where it states it is needed to *"Develop means to make institutional finance accessible to those who have not availed".* As institutional finance is broader than mere micro credit some additional clarification is needed, as analyzed earlier. Some further targets that have been given include:

- savings mobilization has to go up,
- SMEs, small and household businesses should be promoted,
- social insurance should be strengthened,
- health insurance should cover 50% of the population in 2015.

A separate, general directive in the NSEDP stresses the importance of the Rule of Law and training of government officials in areas such as governance, expertise, ethics and morals.

1.3.2 6th NSEDP 2006-2010

185. **The 6th NSEDP (2006-2010) on RMF.** Even though formally the period for which the 6th NSEDP was intended is running out, its main items related to RMF development will be included in the analysis here. The priorities embedded in the NSEDP over the period ending are important to know in order to see how they relate to the priorities stipulated in the Policy Statement (which had been issued before the NSEDP) and the extent to which ADB's priorities had been aligned. The 6th NSEDP had an array of intended actions and objectives related to RMF, most of them without quantification, prioritization or sequencing.[192] Some (parts of) paragraphs are not

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[190] As part of the directives of the 7th NSEDP the LPRP has outlined four Breakthrough approaches to leading socio-economic development principles: 1. Breakthrough in thinking: eliminate the impact of bureaucratic centralized and state subsidized mechanism, making economic development central; 2. Breakthrough in human resource development: invest in education and health, creating a skilled labor force; 3. Breakthrough in mechanisms, procedures and administration: delivery of administration and services in an effective and transparent manner, create favorable conditions for equal competiveness under the Law, and make steps towards being part of the Asian Community (ASEAN) and WTO; 4. Breakthrough in Poverty reduction: mobilizing funds, creating infrastructure.

[191] The source is the speech of Political Bureau member and Standing Deputy Prime Minister H.E. Mr Somsavad Lengsavad on 19 March at the 9th LPRP National Congress.

[192] As the 7th NSEDP is not yet detailed enough, the 6th NSEDP is analyzed to find clues on the real RMF policy setting.

coherent with other parts of the same document or at odds with the RMF Policy Statement.[193]

186. **The 6th NSEDP emphasizes credit and targeted, subsidized credit.** Most significant is the emphasis put on credit as a way to fuel economic development in general and to help reduce poverty through subsidized, low-interest credit to the poor, to women, to the handicapped, to those in rural areas and those with micro enterprises. For this both VRLFs and State-owned banks including APB are seen as important channels.

187. **The 6th NSEDP promotes VMLFs as main RMF provider.** Generally, semi-formal providers are seen as an important and successful means of RMF provision, and the government wants to extent their outreach and to increase their quality. VSLFs and VRLFs are mentioned interchangeably, even though their performance as RMF provider is distinctly different.

188. **The 6th NSEDP acknowledges existing BOL's interventions in and existing preference for SOCBs.** Regarding commercial banks the NSEDP states on one hand that the government intends to reduce interventions in banks' operations and that all banks, including SOCBs, should be self sufficient. On the other hand however the NSEDP states it will guide banks' operations.[194] The NSDEP further states that the government intends to eliminate its preference for SOCBs (over privately owned banks) and that APB should become a self-sufficient, market oriented, rural financial institution.

189. **The 6th NSEDP is could be clearer on interest rate liberalization for the formal sector and suggests BOL will determine interest rates.** Regarding interest rates the NSEDP could do with additional clarity. On one hand the interest rates are deemed too high and it is stated BOL should guide and even moderate the rate, while on the other hand it is suggested BOL should only use indirect measures, such as open market transactions and setting the key interest rate at which commercial banks can borrow from BOL.

190. **On RMF: 6th NSEDP and Policy Statement could have been better aligned.** As can be seen from the content of the NSDEP, there is ambiguity regarding the policy setting for the RMF sector because on internal inconsistency within the NSEDP and lack of congruence with the Policy Statement. The NSEDP mentions subsidizing lending through APB, a still existing preference for State owned banks,

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[193] See Prime Minister Decree on BOL (40/PMO, 06/04/2000):
Article 2.3 To study and improve the law system, presidential and government decrees that concern the monetary system, credit and activities of banks and other financial institutions, then propose them to the government or the National Assembly for approval and issuance of decrees and regulations to manage banks under its authority.
Article 2.4 To establish and improve the state and commercial banking system for sustainable growth. To establish confidence in the users of the bank and investors, both domestically and abroad. To expand international cooperation in the banking sector.

[194] It even details that the government will encourage commercial banks to extend credit to profitable projects and evaluate requests for funding on creditworthiness. This is a confusing and interesting statement as it suggests banks would possibly intend to delivery credit to unprofitable projects and not assess creditworthiness, which a normally functioning commercial financial institution would obviously never intend to do.

interference in banks' operations, supporting VRLFs and emphasizes subsidized credit as a solution for poverty reduction.[195] [196] [197] This while the Policy Statement specifically states that banks should be enabled to do RMF provision, that subsidized credit undermines sustainable RMF provision, that a well developed RMF sector could foster savings mobilization (rather than mere credit), that financial tools that enable risk management, income smoothing and financial connectivity should be developed, and that RMF is not for the poorest living in the remote areas. Most importantly, the Policy Statement has a distinct demand-oriented approach.[198]

191. **Conclusion: need for additional clarity on policy direction towards financial sector including RMF.** What is found here is a struggle to find a balance between allowing market dynamics to deliver the needed financial sector output on one hand and centrally planning and instructing the (state-owned) market players on the other hand. For the future, it is well advised to align, provide additional clarity and most importantly, to develop a single, consistent vision on RMF development.

192. **The 6th NSEDP on social and private insurance; social insurance for all is main objective.** On social insurance the NSEDP emphasizes the long-term objective of having a social insurance system for all as a way to prevent poverty. Health insurance and a health equity fund should be introduced, while the health-financing system should be improved. On private insurance the need for strengthening the capacity of the government is mentioned in order to develop and monitor the regulatory setting and increase minimum capital requirements. Interestingly, the NSEDP states it will encourage insurance companies to study on new products, particularly aimed at the agricultural sector.

1.3.3 PMO Decree on SME Promotion and Development

193. **PMO Decree and Strategy on "SME" Promotion and Development.** The official definition of SMEs excludes businesses that have not fully registered with all relevant authorities, which alone exclude most enterprises.[199] Putting aside the issue

195 Add odds with the principle of a level playing field as found in the Law on Commercial Banks Article 6. Equality in Business Operations: "Commercial banks established and operate banking business in the Lao PDR, shall be equal under the laws to cooperate and complete each other in order to expand production and business operations. The State uniformly regulates commercial banks based on laws and regulations and the State protects the rights and legitimate benefits of commercial banks.

196 While as we have seen earlier poverty in areas with high poverty rates are a consequence of the overall local investment climate (ICA 2007) and overall lacking access to markets, which both are caused mainly by lacking infrastructure (Epprecht 2008). In those areas people tend to borrow exclusively for emergency reasons.

197 NSEDP's relation so the recently issued Financial Institution System Development Strategy 2009-2020 is also in need of clarification. On this Strategy more will be elaborated below.

198 The 6th NSEDP does mention the Policy Statement in a single paragraph, stating that APB will be a self-sufficient, market-oriented rural finance institution and that the Policy Statement aims to promote sustainable development of the microfinance industry by encouraging microfinance institutions to have diverse forms and ownership, and to discourage subsidized credit. However, not only does the Policy Statement stipulate more, it is also largely at odds with the main priorities on RMF mentioned in the NSEDP, as elaborated on in the related paragraph.

199 At a minimum includes the tax authorities, the Ministry of Commerce or the part of government responsible for monitoring the specific sector (e.g., Ministry of Education in case of a school). The element of operation according to the prevailing Laws would arguably include being externally audited, which however very few companies are (less than10%).

of formality, as we have seen over 90% of all businesses in Laos are household-based, micro enterprises (MPI DOS 2007, p. 7-19; MPI DOS 2009 p. 65-67). It is those enterprises in which the largest part of economic activity takes places and that employs the majority of the workforce. Looking at size in the official SME definition, it stipulates "Small" enterprises have less than 20 staff. This definition has hardly any distinctive value as 99% of all enterprises in Laos have less than 20 staff (MPI DOS 2007, p. 8-9; MPI DOS 2009 p. 65-67). Since the specific objective of an "SME policy" is to direct support based on the size of an enterprise, the specific definition used renders this policy quite ineffective. Companies with five or more staff and family members are already large enough to be part of a group of less than 10% of all enterprises. When designing support to enterprises based on size and related organizational structure as characteristics which render a specific support need, the policy setting should include specific definitions for micro and household enterprises if support is to be relevant. This way, research into and strategies towards stimulating economic growth can focus on the specific needs that go with the specific organizational structure and size in which economic activity is predominantly taking place and in which most of the workforce finds employment; that of family based micro enterprises. In order to allow for the advantages of economies of scale and of scope to be released, the design should include measures that stimulate, not deter, "micro enterprises" to grow, formalize and become "small enterprises". This refocus within "SME" development on "Micro" and "Household" enterprise development, significantly includes the issue of "access to finance". Constraints in the ability to access finance by enterprises are known to be related to both the size and the organizational structure of enterprises and thus warrant a specific focus. For one, it would include LDB in "micro and household enterprise finance", as formally designated "SME Development bank", which would be a welcome added source of supply.

194. **SME finance largely overlaps with micro and household enterprise finance.** Another way of looking at the same situation would be to say that "microfinance" and "SME finance" in Laos in reality largely overlap, and consequently have similar issues to deal with. Unless of course micro and household enterprises are defined away because of their informality, in which case the organizational structure which employs and feeds the large majority of the Lao population would be out-of-focus, as would be the reasons for the large scale informality.[200]

1.3.4 Policy direction specific for insurance

195. **Private insurance.** Just very general policy directions are observed in policy documents, indicative of the lack of development of the insurance sector. Policy directions mentioned are enhancing the regulatory and supervisory framework, designing regulations that are lacking and improving existing ones, and building institutional building in supervisory agencies with a focus on building human capacity. General statements made were to increase the liberalization of insurance services and to build the infrastructure for financial market development.[201]

[200] And give the concept of micro enterprise its original meaning (microscopic) back once again.

[201] Based on presentation by and interview with the department and division within MOF responsible for private insurance sector supervision.

196. **Social Insurance.** Main policy objectives in the National Health Development Plan until 2020 are in line with the 6th NSEDP and relate directly to main idiosyncratic risk experienced by low-income and poor households:

- expansion of health care network throughout the country, including the remote and mountainous areas
- rolling out social health insurance throughout Laos in order to increase access to health care and to reduce negative socio-economic impact because of health care expenditures
- Targets for social health insurance are to have coverage of 30% of the total population by 2010, 50% by 2015 and over 70% 2020.

2 Sector Constraints and Development issues

2.1 RMF policy framework

197. **Coherent RMF vision and policy setting.** There is a primary need for a coherent RMF vision and policy setting. Various incompatible definitions of RMF can be found in different policy and strategy documents, and in practice. The main definition found is that RMF is directed, subsidized, low-interest loans to the poor in rural areas. The largest part of the total RMF loan portfolio is delivered according to that definition, both through VRLFs and in the form of microfinance group loans by APB and NBB, undermining the efforts to build sustainable, inclusive institutions, and leading to rent-seeking behavior and ineffective allocation. Another definition describes how since the last five years RMF is being conceived by some, as those financial services that are being delivered by formal MFIs, defining away the role of banks, other NBFIs and semi-formal providers, and foregoing the central issue of demand. There is an adequate definition embedded in the RMF Policy Statement which needs to be understood, accepted, supported and disseminated by a critical mass of key policy and decision makers and which should be embedded in the relevant policy documents, in particular the NSEDP and FIDS-2020.

198. **Unambiguous role for BOL.** The process that has started in 1988 to split the previously existing State Bank into different SOCBs and a Central Bank should be continued and completed. BOL should be released of its tasks to do direct lending (by BOL itself and through state-owned banks) and to direct the operational affairs of State owned financial institutions, and generally of its tasks as arm of the executive part of the government. BOL's focus should be on supervision to be able to successfully deal with the rapidly changing financial sector dynamics following the entrance of so many private banks and the commercialization of the SOCBs. BOL's current portfolio of various responsibilities does not allow for the full benefits of increased market dynamics, of true independence of state-owned financial service providers SOCBs (APB, LDB) and of a level playing field. The rapidly developing financial market in terms of the number of providers, portfolio growth and complexity needs a strong focus on supervision to prevent systemic risk and maintain trust in the financial sector.

199. **Policy towards and strategic focus on development of micro and household enterprises.** The current policy setting for SME development should refocus to include ample, significant and specific measures to support household-based micro enterprises, and to enable their growth and emancipation into formalized, small businesses. Economic dynamics and employment are overwhelmingly found in informal, micro and family enterprises, which have their own specific characteristics which are different from those of SMEs, and have their own specific needs in terms of support, including significantly those related to access to finance.

2.2 Coordination and cooperation

200. **Coordination, cooperation.** BOL has been solely made responsible for RMF development. This, while RMF delivery traditionally and still today is a main activity of various other government agencies and mass organizations which have networks at all levels reaching out to every village. Moreover, a range of different types of formal providers of RMF services exist which are supervised by different government agencies and different departments in BOL. Some RMF services are yet the responsibility of other departments or agencies. As a consequence, there is an overwhelming need for coordination and cooperation, both within BOL as between BOL and other supervisors and agencies involved in RMF delivery. Coordination has been identified as a main issue within the RMF supporting infrastructure, both during RMF sector-broad stakeholder meetings such as the one jointly organized by GIZ and UNCDF as well as by researchers (e.g. Flaming 2010). Coordination should also take place with financial sector service providers and development organizations, as the achievement of the objective of developing a financial sector inclusive for low-income and rural households depends on stakeholders at all levels. Coordination should take place around issues that need to be solved, involving all stakeholders relevant to the issue. The coordination and exchange of experience should be done regularly, in a not too formal, open, constructive yet critical setting.

2.3 Information and transparency

201. **Data and information: collection and dissemination.** The quantity and quality of publicly available information on various aspects of RMF service delivery need to be raised. Data collection, publication and dissemination on both RMF demand and supply should be improved, structured and institutionalized.

202. **Data and information demand side.** Research on RMF demand enables identification of the specific features of financial services sought for by RMF customers. RMF needs are known to vary with characteristics such as location, type of economic activity and composition of a household in terms of age and number of members. Poverty, and socio-economic risks and opportunities have been found to be related to the variables such as infrastructure, the presence of investment projects and flooding. Locating and measuring helps to direct appropriate RMF delivery if information is shared and acted on. For example, knowing clients consider easy procedures and the certainty that a loan is available if and when they need one more important features than the level of interest rate can help to design adequate products and distribution methodologies. There are ample examples of the need for more information, among which on the question why demand for private insurance is so low despite RMF customers being vulnerable to idiosyncratic risks, on the feasibility of warehouse-receipt financing and on the needs for finance in the setting of contract farming.

203. **Data and information agricultural risk management and insurance.** Significantly, with natural disasters being such a big risk factor at both micro and macro level for agricultural production, food security and income, there is a strong need for systematic, structural data collection on occurrence of these events (e.g. flooding, pests, drought) and on location and amount of agricultural production and

204. **Data and information on RMF supply.** Improved information provision on existing supply is also needed. Next to needing to know which organizations are offering different financial services (where, in what quantity and with which product specifics), there is a need to know more about the strength of the financial sector providers individually and the sector as a whole. Significantly, there is a strong need to document and share lessons learned, so RMF providers and development can know what is working and what isn't, and adapt their methodologies.

2.4 International integration

205. **International integration.** The Lao economy and financial sector are increasingly being integrated into larger, formal, supranational unions and organizations. Currently integration is being realized in the Association of South-East Asian Nations (ASEAN) and is in the process of being prepared regarding the World Trade Organization (WTO). Since integration into ASEAN and membership of the WTO are key policy objectives of the government and will affect the financial sector, the consequences for financial sector development in Laos should receive ample and increasing attention.[202]

206. **ASEAN economic community and blueprint.** Integration into ASEAN is concrete and will have the most immediate consequences for Laos' financial sector. ASEAN has declared 2020 to be the year of establishment of the ASEAN community and 2015 the year for the ASEAN Economic Community (AEC). The creation of AEC is guided by the so-called Economic Blueprint which includes a strategic schedule to achieve the AEC. The AEC *"will transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy"*.[203] The Economic Blueprint takes into account the different stages of development of the ASEAN countries and allows countries to liberalize certain (sub) sectors only then, when the country's sector is ready in terms of meeting certain relevant parameters.[204]

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[202] For the insurance sector, an explicit and detailed analysis has been made of the consequences from WTO accession by Lord (2010). No assessment is known for the consequences for the rest of the formal financial sector.

[203] ASEAN Economic Blueprint

[204] ASEAN Economic Blueprint: "For the financial services sector: Art. 22. Liberalization measures of the financial services sector should allow members to ensure orderly financial sector development and maintenance of financial and socio-economic stability (All measures for the financial services sector will be subject to prudential measures and balance of payment safeguards as provided for under the WTO General Agreement on Trade in Services). Member Countries would be guided by the following principles in pacing their liberalization measures: (a) Liberalization through ASEAN Minus X formula where countries that are ready to liberalize can proceed first and be joined by others later; and (b) The process of liberalization should take place with due respect for national policy objectives and the level of economic and financial sector development of the individual members. Actions: i. Progressively liberalize restrictions in sub-sectors or modes as identified by each member country by 2015; and ii. Progressively liberalize restrictions in the remaining sub-sectors or modes, which are not identified under "pre-agreed flexibilities", by 2020.

207. **ASEAN and financial services.** To realize economic integration of the services sectors a framework has been agreed which states as central objectives for the finance sector *"greater private sector participation, transparency and disclosure, dissemination of necessary information and an early warning system"*.[205] Specifically for the financial sector, various packages of commitments have been agreed in protocols, specifying which (sub) sectors will be liberalized and which limitations still hold.[206] The banking sector will largely be liberalized, as Laos' regulations are considered ready to meet the necessary commitments. Regarding the banking sector, the sub-sectors *"all payment and money transmission services"* and *"financial leasing"* will be liberalized by 2015, which means within the next 3 years the regulatory and supervisory environment has to be completed, as it the current framework is lacking. For the insurance sector, no liberalization is planned yet. Apart from these specific commitments, ASEAN finance ministers have agreed on general understandings relevant to the finance sector, such as improving transparency of policies, regulations and rules, promotion of public-private sector linkages, development of the human resource base and consumer protection. All issues mentioned that have been agreed by the finance ministers directly impact the regulatory, supervisory and practical realities of the Laos financial sector and RMF service delivery.

208. **Support preparation of ASEAN accession for finance sector.** In three different government institutions (MIC, MOF and BOL) ASEAN related divisions working to prepare Laos' integration into AEC can be found. As a consequence of spreading out responsibilities over various Ministries, coordination and clear, unified communication with the outside world has become a crucial issue.[207] When trying to find out the government's position and ideas on expected consequences for the development of the financial sector of ongoing negotiations and existing commitments in ASEAN not all issues, including factual ones, could be clarified.[208] As commitments made in principle supersede National regulations and impact whole sectors, weight should be given to preparation on both negotiations and consequences. It was indicated during interviews that negotiations were difficult as understanding of issues at hand is limited, language skills are lacking and the Lao delegation is small compared to other ASEAN countries.[209] Support to negotiations in ASEAN setting related to financial sector was been explicitly requested.

209. **World Trade Organization (WTO).** Regarding WTO accession, an explicit and detailed analysis has been made of the consequences for the insurance sector in Lord (2010). No assessment is known for the consequences for the rest of the formal financial sector. Still, for Lao companies wanting to do business abroad following WTO accession, the lack of development of its home banking sector might hinder its success in foreign markets. Similarly, if Laos might consider bilateral trading agreements with other countries to bring in investment capital, knowledge and trade

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[205] ASEAN Framework Agreement on Services or AFAS

[206] Under the ASEAN Framework Agreement on Services

[207] As illustrated during preparation of this report, finding the responsible authority and officer was an exercise in itself.

[208] As a consequence, most information has been taken from the ASEAN website, including the commitments agreed to by the responsible Minister's of all ASEAN countries.

[209] Illustrative might be the fact that Laos has no member in the ASEAN Insurance council, as only country next to Myanmar.

networks to enable socio-economic development and job creation for low-income household members, opening up the banking sector could be a pre-requisite. The issue is important also in the light of the priorities given by the Lao government to both WTO accession and to the return of native Lao people living abroad to take part in the development of their native country. Large numbers of Lao nationals and native Lao live abroad and are increasingly involved in socio-economic activities in or related to the Lao PDR. Indicative of the importance of this network, the estimated value of annual remittances to Laos is 34.5% of GDP or $1.9 billion at current price of 2009. [210]

2.5 Regulatory issues innovations: assessment of feasibility

210. **Agents: cash-in cash-out, cross-selling and outreach.** There is need for an assessment of the feasibility aspects of the involvement of "agents" in financial service delivery. The assessment should be the basis for the development of a strategy and a regulatory framework enabling agents' involvement. The strategy should be developed in close cooperation with relevant private sector providers both within and outside the financial sector, and with the financial sector authorities. Physical outreach of the formal financial sector is lacking and costly while various organizations involved in financial service delivery (banks, LPFI, MFIs, private insurance companies) and other markets (telecom providers) build their own networks, operating parallel to one another, selling just the single product which is produced by the organization they are an agent of. In order to facilitate the use of agents, the provision of much needed small cash-in and cash-out transactions and cross-selling of simple, standard products an enabling regulation should be developed, which should deal with the central issues of consumer protection, and the liability of the financial service providers and their agents.

[210] "Sending Money Home: Worldwide Remittance Flows to Developing Countries", IFAD 2006.

Table 11: Outlets RMF providers and potential agents

	since	# branches	# service units	Total staff	sales/credit officers	agents
APB	1993	17	60	915	256	-
LDB	2002	18	39	1,076	200	-
NBB	2006	6	46	na	na	-
PSB	2007	4	15	350	70	-
ABL	2008	4	10	398	108	-
Total **commercial** banks		43	123	> 2,739	634	-
LPFI	2000	18	125	45 (200)	20	-
Licensed MFIs	2004	22	-	250	60	-
Lao Telecom	1993	-	52	1,900	na	> 2,000
Tigo	2007	-	-	na	na	> 5,000
Private insurers	1992	-	-	< 100	na	> 2,000
VMLFs	1990	-	4,114	30,000	-	-

Sources: Financial Sector Statistics (BOL); "Microfinance in the Lao PDR" (NERI, 2009); data provided by BOL and institutions interviewed as part of this study.

211. **Payment system.** Payment system in a narrow definition refers only to the system to settle payments between banks, organized under the responsibility of BOL. Currently, an adequate regulatory framework for this system, which is technically being developed, needs to be created. The payment system from a broader perspective looks at the total infrastructure that enables the transfer of funds, from payer to payee. The easier, the lower the costs and risks involved in transferring funds, the higher the output of the real economy. In this broader definition, all regulatory, organizational and technological improvements aimed at facilitating payments by all organizations able to providing payment services are included in the definition of development of the "payment system". IT plays a crucial role and for banks to be able to join in the improvements, a good quality CORE banking system is a necessary condition.[211] A good-quality CORE banking system allows leverage of many existing technological facilities enabling payments, ATM, the use of POS, debit and credit cards, internet banking, and, significantly, mobile and mobile-phone based banking. In this broader definition, the creation of a set of regulations enabling improvement of this overall system has the potential to strongly improve RMF service delivery, increase outreach in terms of number of outlets, decrease transaction costs, increase accountability and increase depth of service delivery and enabling the delivery of products which previously could not be delivered in an economically viable manner.[212]

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[211] A Core Banking System is a back-end system that processes daily banking transactions and posts updates to accounts and other financial records. Core banking systems typically include deposit, loan and credit-processing capabilities, with interfaces to general ledger systems and reporting tools.

[212] Also: "Enhancing Rural Development through Improved Infrastructure and Innovative Information Applications; LAO P.D.R Country Report: Applications, Francisco J. Proenza, FaO Investment Centre, 3 June 2007.

212. **Payment system regulatory setting.** For banks no regulations have yet been issued for electronic and internet banking, as demanded by the Law on Commercial banks.[213] A regulation on involvement of agents in financial service delivery could enable cash-in, cash-out transactions through the large networks of telecommunication and private insurance companies. There are at least two telecommunication companies willing to consider delivering payment services. Their involvement would help to create the outreach needed to overcome the challenges caused by the low population density and lacking physical infrastructure, in particular the high transaction costs for monetary and economic transactions. Currently, there is no separate regulation that allows non-financial institutions such as telecommunication companies to enable money-transfer services, despite the economic potential and presence of organizations able to technically provide the necessary services.[214] Next to regulation, an IT-technical system needs to be built that secures the safety of the transfers. Consumer protection and safety should be a main part of the regulation for any form of payment facility, just anti-money laundering concerns. The need for a regulatory setting is urgent, if only because, as we have seen earlier, improved payment facilities open the doors to the provision of other RMF services. The urgency is also there because of a license that has recently been granted to Lao Telecom by BOL to do money transfers under the name "M-Money". The license has been given without any pre-licensing scrutiny and allows Lao Telecom to act as a financial institution without any known conditions. During a pilot last year Lao Telecom realized the responsibility it had taken on and its lack of necessary knowledge on how to manage basic elements of being a financial service provider, and halted its activities. To complete the picture we mention the need for regulation of the use of debit and credit card services, which are currently already in use without any known form of consumer protection.

213. **Feasibility studies: Warehouse-receipt financing, agricultural insurance and financing of contract farming.** Feasibility studies have to be undertaken to identify the feasibility aspects of various agricultural finance related issues. First of all there is a need for assessing the feasibility of enabling warehouse-receipt financing. The study has to be closely coordinated with the MAF and its program to create a system of warehouses, with commercial agricultural organizations using warehouses as part of their core business, with organizations and farmers making use of the warehouses, and last but not least with banks and BOL. Secondly, there is a need for an assessment of the value, need and feasibility of offerings agricultural insurance. Food security is a main issue in Laos at micro and macro level, and natural disasters hit hard into main staple (e.g. rice), commercial farming (e.g. maize) and livestock, directly impacting food security for many low-income and rural households. Finally, offering competing finance for farmers engaged in contract farming has the potential of lowering finance costs for farmers and could help identify a market for financial service providers.

[213] Articles 59 and 60 of the Law on Commercial Banks.

[214] "Enhancing Rural Development through Improved Infrastructure and Innovative Information Applications; LAO P.D.R Country Report: Applications, Francisco J. Proenza, FaO Investment Centre, 3 June 2007.

2.6 Banking sector

214. **Development issues: banking sector.** Banks play a major role in RMF delivery and have the potential of being the most significant providers in the future. Currently however, because of a combination of regulatory and supervisory constraints this potential can not be fully realized. This, despite the fact that banks are explicitly mentioned as RMF providers in the Policy Statement, and despite the fact that ADB's support to APB specifically aimed at allowing APB to *"operate in a market-oriented, financially sustainable way in order to make a long-term contribution to poverty reduction and the country's economic growth and prosperity"*.[215] [216]

215. **First main constraint RMF delivery by banks: 5% cap on interest rate spread.** The main constraint for banks is formed by a notice issued by BOL to maximize the spread between interest rates on deposits and on loans to 5%.[217] Service delivery to the RMF segment as found in the rest of the world and indeed in Laos has a higher cost loading than delivery to larger clients in larger amounts, costs which can not be recovered from a 5% margin.

216. **APB and LDB.** APB and LDB find themselves in a paradoxical situation with contradictory assignments. On one hand they have been given the assignment to perform as a commercial bank and to deliver loans to the segment of lower-income and rural households (APB) or SMEs, of which almost all are micro enterprises (LDB). On the other hand they are not allowed full recovery of the costs incurred and risk compensation allowance. As a consequence APB and LDB are forced to find markets in larger loans and in foreign currency, and are not enabled to develop the products and delivery mechanism that are demanded by lower-income and rural households, and by micro enterprises. This situation, combined with the instruction from the government through BOL to increase lending and use financial-capacity based loan assessment makes that both banks will soon run out of funds without additional government funding support as they can also not compete at the market for deposits and have little access to external borrowing.

217. **Negative effect on demand oriented RMF delivery and outreach.** For RMF customers total benefits and total costs of a financial service are what matters. The interest-rate cap disregards the relevance RMF clients attach to non-interest rate costs and to flexible products with easy procedures, delivered by financial service providers that are there when they need them and with whom a relationship of mutual understanding and trust can develop. As can be observed in practice, despite the fact that loans are available at interest rates below 1% per month through banks, literally tens of thousands of people borrow at 4% per month from VMLFs and MFIs. The latter two provide the product characteristics RMF customers are looking for, with lower non-interest rate costs that more than off-set the higher interest-rates. Informal credit delivery through different types of moneylenders happens at rates up of

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[215] As my colleagues working on component 1 of this TA 7500 have assessed both the banking sector and banking sector supervision, here the assessment of the banking sector will only include issue affecting RMF.

[216] Governance Agreement APB, revised version, October 2008

[217] No. 111/BOL, 28/04/2006

sometimes even up to 200% per annum (Coleman 2006). Credit extended in the morning for a day to traders on markets in Vientiane can be observed to be repaid in the evening with added interest of sometimes up to 25%.[218] For banks making the product adjustments to meet their clients' demand, such as improvements in loan design and distribution, would not be financially viable as the cap prohibits full cost recovery. As a consequence, outreach remains low.

218. **Negative effect on banking sectors financial and institutional soundness.** The reason given for maintaining the cap is controlling the profit of banks. However, the banking sector in general and the banks involved in RMF provision in particular are not at all particularly profitable, while the composition of profit sometimes hinges largely on non-regular income, such as on written-off loan portfolios. SOCBs ADB and LDB, but also banks such as PSB do not meet CAR requirements and need profit to strengthen capital. Extra margin is also needed to fund investments in improved systems, building staff capacity, develop products and improve distribution channels and to compensate for inflation.

219. **Cap not in line with RMF Policy Statement and FIDS-2020.** The cap goes directly against statements in policy and strategic documents concerning the financial sector including the Governance Agreement for APB as part of ADB's assistance signed by both BOL and MOF, which states that *"APB should make a profit on all of its activities..."*.[219] Admittedly, the GA has expired, but APB's current mission and vision still claim it will work as a self-sufficient, market oriented provider. The recently issued PMO Decree containing the FIDS-2020 also states there *"is full liberalization of interest rates"*.[220] Last but not least, as seen earlier, also NEM, so fundamental to socio-economic development, goes on the explicit foundation of full cost recovery.

220. **Second main constraint: lack of decision-making discretion for APB and LDB management.** APB and LDB management are given little room for designing and implementing a strategy aimed at becoming a self-sufficient, financially and operationally sound commercial bank. They are given a segment of the market to serve, with makes for inefficient use of the banks infrastructure and high risk profile due to lack of lack of diversification, and are limited in discretion to develop products and delivery mechanisms. For a sense of ownership, responsibility and stake, management should be allowed the discretion and be given a full mandate.

221. **Need for clarity on and encouragement of banks' role in RMF service delivery.** As also found by Flaming (Flaming 2010, p. 3, pp. 7-8) banks have the perception BOL wishes to discourage banks from providing services to the lower end of the RMF segment. For banks that are willing and able to engage in delivering financial services to lower income and rural households in a setting which they perceive as less than clear with regard to the financial sector authority's support is something which has the potential to discourage those banks from making the decisions to invest in improved quality of and outreach in RMF service delivery. A

[218] Anecdotal observations made on Vientiane markets over the course of 2011.
[219] Governance Agreement APB, revised version, October 2008, page 8, article 1.5.2
[220] FIDS until 2020, page 10.

clear statement by BOL allowing banks to engage in RMF service delivery could have strongly positive influence on the development of a sustainable RMF sector.

222. **Development issue: banks' institutional capacity regarding RMF delivery.** The capacity to assess financial capacity and the willingness to repay of lower-income and rural households, to understand their socio-economic situation and business dynamics in their local context, and to build a relationship based on mutual trust are crucial elements for successful RMF provision. Related needs are adequate internal control and risk management mechanisms, specific product design and distribution methodologies aimed at RMF clients, supported by a good quality MIS. Large outreach allows economies of scale and of scope, necessary in a market segment with normally high cost loading. In Laos, of the banks involved in RMF delivery, only ABL comes close to encompassing all attributes described and is backed up by a strong mother company, by a related training institution and by long-term strategic partners with relevant vision, knowledge and experience. Still, also ABL needs time to roll out its network of branches and build up its staff capacity. APB and LDB, apart from still not having completed the rollout of their CORE banking system over their branch network, have only started cash-flow based lending in 2008 after the turnaround to become a self-sufficient market oriented bank, and need continued TA. Also PSB needs institutional strengthening.

2.7 Non-bank financial institutions

223. **LPFI.** The LPFI faces similar issues as the SOCBs even if supervised by the FISD. Because of its specific features, it has the potential to become main provider of low-cost, demand-oriented financial services in the form of basic savings products, giro or current accounts and money-transfer services. The LPFI should be given the free hand by BOL to do so, and be technically supported in developing and implementing a strategy by organizations specialized in providing Postal Financial Services, either UPU or (development departments of) large, successful international postal financial institutions. Because of its specific features as a postal financial service provider, LPFI should be treated accordingly, on the basis of its own specific and unique features, not in a general way as either an MFI or a SOCB.

224. **Lao Telecom and telecommunication companies' potential contribution to RMF delivery.** Telecommunication companies such as Lao Telecom (and Tigo) have the potential to help overcome the challenges caused by low population density and lack of physical infrastructure, by providing a huge network of branches and agents combined with mobile-phone technology. If safety measures would be built, the networks could provide for inexpensive, fast, reliable, transparent, accountable and low-risk ways of transferring money to almost the complete Lao population. Needed are open and constructive discussions between telecommunication providers and BOL, supported by specialist on creating mobile-phone money transfer systems, in which creating the necessary legal and technical security should be central issues. The question whether or not the telecommunication provider should become a financial service provider (which Lao Telecom wants) or a provider of electronic communication enabling financial service providers' money transfers (what Tigo would consider) is a key issue to be dealt with. To maximize leverage for the sector, taking into account that Lao Telecom has no experience or knowledge at all in

financial service provision, combined with the fact that a large number of banks has now been established with high-quality MIS systems, it would be most beneficial to the RMF sector if Lao Telecom and Tigo would be enabled to deliver non-financial services to the whole banking sector.

225. **Lao Telecom as RMF provider.** If Lao Telecom still has the desire to become a financial service provider, to a minimum both technical and legal measures have to be taken to secure the safety of services to their customers, including definitions of which services can be provided under which conditions and which organizations can function as agents, and again under which conditions. The current situation, in which Lao Telecom has been given a license to provide financial services without any restriction, without pre-license scrutiny, conditions or supervisory framework is hazardous and the FISD is advised to address the situation.

226. **Pawn shops.** Throughout history and in different parts of the world pawning has been a widely used means for low-income households to quickly, easily turn moveable assets into liquid monetary form. Because of low risk for the lender interest rates can be low(er), and the combination with low transaction costs and an easy procedure makes pawning a relevant means of accessing funds for emergency reasons and income-expenditure smoothing. The total lack of publicly available information on pawn shops in Laos hinders further assessment on their performance. The need in Laos' population for loans that help deal with emergency situations or help match income and expenditures, combined with the lack of provision of these types of products by the remaining formal sector suggests an important role and consequential market for pawn shops, protecting low-income households from having to borrow from moneylenders at usury rates or conditions. The fact however that pawn shops have been regulated and licensed yet are not supervised is a situation which should not continue, as has it has an inherent risk of erosion of BOL's authority. A license given by a Central Bank should be a sign of reliability of a financial service provider. Supervision should protect consumers from usury behavior by pawn shops (e.g. pawning land titles, high interest rates, selling pawn without notice or prematurely) and prevent money laundering. Because of FISD's lack of experience in supervising pawn shops combined with a lack of supporting pawn shop specific supervisory framework (e.g. reporting formats, supervision guidelines etc.) the FISD should be supported to take on this responsibility.

2.8 Microfinance institutions: regulatory and strategic issues

227. **Overview assessment regulation and supervision.** The overview in this paragraph serves to explain which regulatory and supervisory issues have been assessed as part of Component 2 of this ADB TA 7500. Some initially planned activities were rescheduled as agreed by BOL and ADB, because they were already undertaken as part of other development programs.[221] Regulatory and supervisory

[221] The Inception Report made as part of Component 2 of ADB TA-7500 details the agreement between ADB and the government on prioritization of activities. ADB and the government agreed to substantially reduce inputs into regulations review as this has been conducted by GIZ, where ADB will limit its activity to commenting on draft revised regulations. This approach has been decided on so donor institutions can complement activities among others in order to maximize the effectiveness of the projects as a whole.

issues related to banks have been dealt with as part of Component 1 under this TA 7500. Regulatory and supervisory issues concerning MFIs, the MFId and its successor the FISD have been supported by the German international cooperation organization GIZ. Regarding regulatory and supervisory issues related to MFIs it was agreed that Component 2 would limit its activity to commenting on draft revised regulations. However, as the revised regulations and draft PMO Prime Minister Decree on MFIs has been handled in closed sessions with invited stakeholders only, an assessment of the current microfinance regulations has been made in stead and can be found in paragraph 2.8. Regarding capacity building and training needs of the FISD it was agreed to limit input to a training needs assessment through a gap analysis to all trainings provided by donors. Supervisory issues and an assessment of the capacity development needs of the successor of the MFId, the FISD, are dealt with below in paragraph 2.9.

228. **Deposit-Taking MFIs.** The regulatory framework for prudential licensing and supervision of DT MFIs has been adequately established. Regulatory issues have arisen outside of prudential financial supervision. One issue relates to alignment of the classification of different types of MFIs with the registration system used by the MIC and should be solved by coordination between BOL and MIC. Another issue is related to tax, as the tax department does not accept loan-loss provision as deductable item for MFIs where it does for banks, and uses its own Chart of Accounts next to and on top of the one used by BOL, leading to an extra administrative burden for MFIs. Thirdly, DT MFIs are required to become members of the DPF which so far has not allowed this, as the DPF's Charter only sees to admission of banks. MFIs are limited to a maximum loan size of KN10 million which excludes actual demand of some lower-income household's entrepreneurial activities. Both banks and VSLFs are known to experience and service demand for loans by low-income households up to KN20 million, the inclusion of which could both strengthen the MFIs portfolio and diversify its risk. As the lacking skills of the young MFIs in assessing borrowers repayment capacity would render "larger" loans potentially risky, loans over KN10 million could be allowed possibly only up to a percentage (e.g. 1%) of capital (minimum registered and paid up capital is currently KN1 billion) and possibly up to a certain percentage of total loan-portfolio, and should be limited to MFIs that meet all relevant prudential criteria.

229. **DT MFIs in the RMF spectrum.** DT MFIs operate in a RMF setting with large-scale presence and outreach of VMLFs, which have the benefit of political support through their relation with mass organizations and local-government representatives. This is of particular importance in a country where social organization and economic development are normally managed top-down by a central authority. Since 2007 also banks have become competitors for DT MFIs in the market for deposits and loans at a rapidly increasing rate. Banks are generally considered a safer place to deposit and have the capital base to invest in important issues such as PR campaigns, product development and human resource development. The DT MFIs operate in a setting which overall is highly informal and someone with a substantial amount of money can simply become an informal money lender without much ado, and forego the burden of reporting to BOL, having to manage a complicated administrative system and internal control measures and, last but not least, of paying taxes. Money lenders can also forego legalities related to reimbursement and selling collateral. This comparison is relevant, since in order to

start a DT MFI an amount of KN1 billion needs to be available up-front as registered and paid-up capital which only few Lao people are able to do. Next to the monetary capital, human capital needs to available. The available knowledge and experience needed to successfully run a DT MFI is scarce. Those who have the skills can often generate higher income and less risk working in the banking sector, within the development industry or as a consultant. Moreover, as we will see below, training institutions available to help build the institutional capacity of MFIs are virtually absent or considered very expensive. As a consequence, good-quality DT MFIs delivering RMF services to a large customer base other than civil servants or at reasonable interest rates are absent.

230. **Future options for DT MFIs**. Allowing foreign investment in MFIs would enable the necessary inflow of the financial, human and institutional capital that is currently lacking in Laos. Secondly, a DT MFI owned by a mass organization or a part of the government would allow for the combination of the benefits of a formal, good-practice governance structure and a social mandate, political back-up and a large network. Thirdly, allowing DT MFIs to become part of the DPF would enhance their capability to generate funding through deposits, lower their funding costs and offer a most needed RMF service.[222] From a supervisory point of view, looking at the levels of risk posed by DT MFIs for depositors, strict adherence to prudential criteria should be imposed before allowing DT MFIs to join the DPF, which could have the additional benefit of increased attention within the MFI for internal control and risk management.

231. **MFIs have to find unique position.** For MFIs, being surrounded by both VMLFs and banks, the unique selling proposition has to be found in delivering products with features that add value to their RMF clientele and are not (yet) found in products offered by their competitors, the VMLFs, banks and moneylenders. These features include demand oriented products, innovative distribution technologies that lower non interest rate costs and in general the low-threshold service delivery that is typically found in successful MF deliverers.[223] To enable MFIs to be successful, they should be allowed to import knowledge, experience and solutions from outside Laos for which long-term strategic partnerships combined with a financial stake would be the appropriate channel.

232. **SCUs in Laos.** Self-help, self-governance and self-responsibility are key principles of the original financial cooperative movement. Based on these principles, mobilization of social capital, and stimulating thrift, a savings habit and a sanitary life, a not-for-profit motive, a community or village orientation and member ownership all have become main features of the saving and credit cooperative model. The same principles and features are also found in the Lao VSLF model, as we have seen a main type of RMF provider in Laos and form the basis of the government's approach to poverty reduction and socio-economic development. Interestingly, the success of the financial cooperative model has its basis in a setting which is very

[222] For more on the Depositor Protection Fund see below, paragraph 3.3

[223] Experience in Laos has shown for example that daily cash collection can strongly raise savings mobilization and loan repayment. Visits by credit officers to villages at strict intervals (e.g. once a week) allowing clients to make payments in order to save, pay interest or repay principal has greatly enlarged the number of clients, loan repayment and savings mobilization. Easy loan application and loan renewal procedures have also shown to be able to enhance the number of loan request.

similar to the current Lao socio-economic setting. Germany's 19th century development from a rural, agricultural oriented society to a more industrialized one brought with it phenomena such as urbanization, change in traditional family structures and in social networks, poverty as well as financial exclusion of the lower-income and rural households, and formed the background against which financial cooperatives emerged before successfully spreading out to countries such as Canada, France, the Netherlands, England, Australia and the USA. Despite the similarities between the VSLF and the original financial cooperative models, in the Lao PDR it has been the VSLF model which has been successful so far, and has added some uniquely Lao features.

233. **SCUs and VSLFs.** As explained by Seibel (2004), "development from below", of which the traditional SCU model is an example, is more successful in open societies. In societies such as Laos, which are more hierarchal, closed and more oriented towards status, tradition and preservation of stability, development is most successful if organized or initiated by the established authorities. Looking at the situation in Laos, indeed the leverage created through politically strong organizations with large outreach such as the LWU, MAF and PMO has been a critical factor in the success or the VSLF model. The adaptation of the savings and credit cooperative model by adding a compulsory committee of village representatives of LPRP, mass organization and government to the member-elected management committee has given the VSLFs a structure that has made it suitable to the Lao setting. The combination of bottom-up self-help with management through a central authority fits well with the basic organizational principle of the economy as embedded in the Constitution, that of a *"market economy regulated by the State in the direction of Socialism"*. The combination of these seemingly opposing basic principles, central-authority leadership and bottom-up emancipative self-help it shares with the People Credit Funds in Viet Nam, where based on this combination a successful cooperative sector was built.[224]

234. **SCUs, VSLFs and BOL.** There is one significant difference though between the situations in Viet Nam and in Laos. While in Viet Nam it has been the Central Bank which has steered the successful development of the People's Credit Funds, in Laos the financial sector authority has not been involved in VSLF development. A project office of the central LWU combined with and district (and village) authorities of LPRP, mass organizations and government have been at the basis of the successful development and implementation of the model. The model has evolved over time as lessons were learned along the way and resulted in "Guidelines" sent to all villages, almost like semi-formal microfinance regulations. When the formal MF regulations were prepared and issued by BOL, this happened as in a parallel universe.[225] The official BOL MF regulations have not yet managed to find a way to adequately incorporate the reality of the VMLFs and in that sense could be described as "supply driven". Apart from the fact that most VMLFs are not aware of existing regulations, the ones that are aware are for the most not eager to follow to say the least, even if it

[224] "The People's Credit Funds of Vietnam: A prudentially Regulated Credit Cooperative Movement", Hans Dieter Seibel and Nguyen Thac Tam in "Enterprise Development & Microfinance, vol. 21, nor. 2, June 2010, pp. 137-153.
[225] As one official explained it to me, "there is BOL microfinance and there is LWU microfinance".

were possible, since they do not see much advantage of adhering to BOL's MF regulations.

235. **Advantages semi-formal VSLF versus formal SCU.** The creation of "village development funds" as they are mostly called, is based on "Guidelines" sent from high political level. An objective of the government is to have a VMLF in every Lao village and powerful agencies such as the LWU, MAF and decentral authorities work to achieve this objective for which they find support from the many international development organizations. Next to the political interest, there is a financial interest, as decentral and local authorities are well rewarded for their involvement in the VMLFs in the form of direct and indirect financial returns. Importantly, in particular the VSLFs generally work relatively well or at least are broadly appreciated by most stakeholders, as many benefit including which prominently the member-"savers". The combination of the general appreciation for VMLFs, the interests of the politically strong VMLF instigators, the political and cultural embeddedness of the VMLF structure and their ubiquitous presence make that the newly issued BOL regulations for SCUs (and NDT MFIs), which as mentioned did not incorporate the realities and features of the existing VSLF, have not yet been able to be very successful so far. As a consequence, the potential benefits of formalization, regulation and supervision so far have eluded the RMF sector.[226] We use "potential" to stress that so far the institutional capacity or outcomes of existing formal SCUs have not in all cases been so much better than those of VSLFs. Reporting requirements can not be met and too many SCUs have not been able to adhere to the basic prudential ratios embedded in the MF regulations for some years in a row, including those measuring self-sufficiency.

236. **BOL's NDT MFI and SCU regulation.** The regulatory framework for MFIs, including the regulations for NDT MFIs and SCUs, oblige VMLFs to register with BOL, use a prescribed Chart of Accounts, and send yearly income statements and a balance sheet. So far, only a handful has complied and over 4,000 haven't. Larger ones would additionally have to request a license, which would force them to adapt critical elements of their governance structure, become fully formalized and registered, would have to start paying tax and reporting monthly to BOL and undergo both BOL on-site inspections and audits by an external auditor. Those demands put on MF providers by BOL regulations are currently beyond the institutional capacity of most providers. Moreover, the demands put on BOL by its own regulations are currently beyond BOL's capacity as well. Even if it would be possible to bring BOL's capacity to a level which would enable implementation of the current combined NDT MFI and SCU regulations, and foregoing the constraints mentioned in the previous paragraph, the effort needed would not warrant the envisioned potential benefits (also: Flaming 2010, Seibel 2010).

237. **SCUs, VSLFs, BOL, regulations and the way to the future.** For the future, VSLFs, and their partners in the government and in mass organization should engage with BOL to develop a joint vision on VSLFs and their role in RMF development, and find a mutually beneficial way to include VSLFs in the formal sector. The first

[226] Benefits such as stronger institutions, integration of grassroots RMF providers in the overall larger formal finance sector, with diversification of risk, liquidity allocation to productive regions or institutions, enlargement of scale, improved transparency and governance, depositor and consumer protection, outside technical assistance, lower risk premiums, all as positive effects.

and central objective should be the mutual understanding between BOL and the stakeholders involved with VMLFs. This requires openness on both sides, and the willingness to get to know and understand each others RMF principles, methodologies and interests. To enable this, a platform of communication and coordination should be created which should focus on finding a way forward for VSLFs that allows for the benefits of supervision and enables integration of VSLFs in the formal financial sector in a way that strengthens them and stimulates their development.[227] Concrete solutions can not be given beforehand but some clues as to options that could be discussed and explored will be suggested here. Options that should be considered are (see also Seibel 2010, Flaming 2010):

- To withdraw the requirement to register for those VMLFs which don't manage (large amounts of) member contributions.
- To adapt the SCU regulation to fit VSLFs and to include an allowance for small village-based SCUs with an organizational structure that meets current practice. For small village-based SCUs less burdensome accounting and reporting requirements should be considered when compared to current regulations. A standard, basic format able to be managed by the village-based SCUs should be considered yet should be designed to allow for enable meaningful reports. When considering adaptation the possibility of lighter or delegated supervision should also be assessed**.**
- To define, support and formalize the role of (existing) informal support structures into Network Support Organizations (NSOs) with a governance structure that allows for intermediation of funds between the village-based SCUs and for representation on behalf of associated village-based SCUs by the NSOs in communication with BOL. The NSOs could collect data on associated village-based SCUs, could monitor them and could play a role in delegated supervision on behalf of BOL. Next to direct interaction with the formal sector by SCUs, NSOs could be enabled to link with formal financial sector providers as well and to engage in financial intermediation with the formal sector.

Ultimately, the outcome should be a strategy aimed at developing a strong cooperative sector in Laos (also Seibel 2010). This development should be seen as a constantly evolving and participatory process during which adaptations should be made if and when needed. It is critically important for the success of this development strategy to build on existing structures and practice, at all levels. Key interests should be identified and taken into account or dealt with, including political and financial ones.

238. **More on NDT MFIs.** The NDT MFI regulation intends to allow organizations that do not take deposits from the public and in effect pose a risk to professional funders only with an enabling setting to extent MF loans, by allowing

[227] Very recently a professor of a Japanese University organized a seminar involving BOL, LWU, technical assistance providers to VSLFs including INGOs and practitioners, and involved in VSLFs, on exactly this topic; to study the VSLFs and SCUs and see how the two types currently operate and how to improve their effectiveness. The interest of the Japan based professor stems from his earlier involvement in and knowledge of VSLFs in Vientiane Capital, and from having Lao students take up the subject as part of their university study in Japan.

for a light regulatory regime and the freedom to choose an organizational structure.[228] For organizations that have the technical capacity and either have or can access investment capital and other forms of funding, such as successful large foreign MFIs, NGOs or specialized banks, the model could well function well to enable large scale MF lending if and when foreign ownership of MFIs is allowed. Last but not least, if in the future commercial banks in Laos are still disallowed or discouraged to engage in MF loan provision, the model could serve well as a legal vehicle for banks to engage in the RMF segment.

2.9 Supervision of the rural and micro finance sector

239. **Supervision of the RMF service delivery.** Supervision of the RMF sector is a broader issue than supervision of formal MFIs only. As we have seen, RMF provision involves a broad range on organizations including banks, pawn shops, the LPFI, VMLFs and both social and private insurance providers. Since banks dominate the formal financial sector overall and play a most important role in RMF delivery as well in terms of the number of customers, the managed amount of savings and the number of payments handled, banks should normally take supervisory priority. Concretely, support to the RMF supervisory capacity of BOL should include supervision of banks involved in RMF service delivery and should involve BOL's BSD. Illustrating the importance of an overall concept of supervision of microfinance activities only last year has the Microfinance Workstream of the Basel Committee issued guidelines on Banking Supervision called "Microfinance activities and the Core Principles for Effective Banking Supervision", which relate to both bank and non-bank providers. [229] [230] [231]

240. **NBFIs relative importance.** Despite concluding that banks should probably receive supervisory priority in the previous paragraph, a too conclusive statement can not be made. A lack of information makes it difficult to conclusively assess NBFIs' relative significance as financial service provider and as RMF provider, and their potential for future growth as well as the possible inclusion of VSLFs in the formal sector warrant ample supervisory attention. With increasing demand put on BOL's capacity as a consequence of the growth in number, variety and complexity of financial sector providers and their activities, it is essential for BOL and the FISD to

[228] Those who provide capital or loans to the organization, professional (commercial or development) funders, which should be careful themselves, rather than be protected by BOL's supervision.

[229] The Basel Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central bank Governors of a group of ten countries in 1975. It currently consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Basel Committee provides a forum for regular cooperation on banking supervisory matters with the objective to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

[230] "Microfinance activities and the Core Principles for Effective Banking Supervision", Basel Committee on Banking Supervision August 2010, Bank for International Settlements.

[231] This report only sees to supervision by the FISD as successor of the MFId and will not elaborate in detail on supervision of microfinance activities by banks. Supervision of banks has been dealt with under TA 7500's Component 1.

prioritize, focus and plan supervisory efforts based on an assessment of the risks for the overall soundness of the financial system posed by each (type of) provider.

241. **NBFI and the FISD**. BOL's FISD is responsible for regulation and supervision of non-bank, non-insurance financial service providers. The FISD has been split of the Bank and Financial Institution Supervision Department (BFSD) in August 2010, to deal with the increased supervisory demand made on BOL. The FISD is responsible for a range of different institutions and compared to the MFId, FISD's predecessor, its responsibilities have increased and have become more complex.[232] An overview is given immediately below.

242. **FISD's added responsibilities since August 2010** (compared to the MFId's portfolio). Added are:

i. **Leasing Sector**: five licensed companies, two license requests in the pipeline;
ii. **Non-Financial Companies** (trading) that have received an agency of money-transfer organizations such as Western Union or Money Gram: four companies;
iii. **Lao Telecom**: a telecom-provider in the form of a joint venture between the Lao government and a Thai telecommunication company that has been licensed to facilitate money transfers under the name "Mobile Money";
iv. **Lao Central Payment Network**: a joint venture between BOL and private investors aimed to build a system that facilitates cashless payments using debit and credit cards;
v. **Debt Processing Centre of BOL**: a department of BOL that buys portfolios of loans with repayment difficulties from SOCBs and aims to consequently collect the loans;
vi. **Depositor Protection Fund**: organization that is set up to insure deposits (see below at page 88), part of organizational structure of BOL yet formally independent.

243. **The responsibilities that the FISD has taken over from MFId are:**

i. **Pawn Shops**: licensed (23 companies);
ii. **The LPFI**; licensed
iii. **Funds**: licensed (2 funds); [233]
iv. **Deposit Taking MFIs**: licensed (8 DT MFIs);
v. **Savings and Credit Unions**: licensed (12 SCUs);
vi. The FISD has received 10 registration forms, balance sheets and income statements sent by NDT MFIs.

244. **Suggestion: Role State Audit Organization, MOF and BSD.** Looking at the FISD's portfolio of responsibilities, three organizations seem out of place; the Depositor Protection Fund, the Debt Processing Centre and the Lao Central Payment Network. All three organizations do not directly provide financial services to the public, are outside of the scope and level of technical expertise of the FISD, represent assets or (potentially large) liabilities of the State and represent an interest of the

[232] See Appendix 3 for the organizational chart of the BFSD before 27 August 2010, Appendix 4 for the current position of BSD and FISD in BOL and Appendix 5 for the organizational structure of the FISD.
[233] Regarding the Funds, no information has been made available.

same organization of which the FISD is a department, BOL. Auditing these organizations is beyond the capacities of the FISD, and seems beyond its normal jurisdiction and scope of work. Looking at the interests involved in these organizations and the needed type of control MOF, the BSD and in particular the State Audit Organization seem better placed to assume the responsibility of auditing and controlling. The concerned organizations are either formally, materially or in both respects State owned enterprises which are normally audited by the State Audit Organization. The Debt Processing Centre altogether is a department which seems to belong to the period of before 1988, when there was no separation between commercial banks and Central Bank. It blurs the line dividing the responsibilities of BOL and SOCBs, and makes proper assessment of profitability and financial strength of SOCBs difficult. The Debt Processing Centre and the DPF are significantly important also for MOF to monitor, as MOF on behalf of the State is ultimately responsible for suppleting funding shortages.

245. **Institutions, FISD and supervision.** The remaining NBFIs under FISD's supervision bring different types and amounts of risk but have in common that have been licensed by BOL. Key objectives of supervision are preventing behavior by formal financial service providers that would negatively affect confidence in the financial system, financial sector stability or the rightful interests of consumers, or that would constitute a financial crime.[234] If supervision of certain NBFIs would be beyond FISD's capacity, institutions should simply not be licensed and the distinction should be made explicit and publicly known. If not, the risk exists that trust in the financial system and in BOL supervisory authority would be undermined. Since supervision aims to build a sound and stable financial sector, to create trust and to protect consumers, in those cases where investment in supervisory activities would not be expected to adequately achieve these goals or at a cost that would not weigh-up against the benefits of supervision, regulating and supervising are not worth pursuing.

246. **Licensed NBFIs for which the supervisory system needs further development.** At present not all licensed institutions are actively being supervised.

247. **Payment service providers.** Providers of payment services are under FISD responsibility. Lao Telecom has received a license to provide money transfer services without pre-license scrutiny, regulation, prescribed Chart of Account, organizational structure, internal control mechanism, rules on how to cooperate with agents, prudential requirements and financial ratios related to cash-in and cash-out transactions and cash position, reporting or inspection requirements, and non-prudential requirements related to consumer protection and money-laundering. Handling payments by Lao Telecom involves considerable risks. The total value of funds handled at one time could easily amount to a very large sum even if each of the individual transfers is small, because of the sheer number of outlets, customers and transactions.

248. **Pawn shops.** Supervision of pawn shops deals with non-prudential issues. Consumers need to be protected against issues such as the use of usury interest rates

[234] We forego roles in maintaining internal and external value of the kip, as they are beyond the scope of the report and the FISD.

and not acceptable reimbursement procedures, the latter including the use of land titles as pawn and premature selling of the pawn, money laundering and generally in engaging in financial service provision outside the scope provided by the license. For pawn shops, a Prime Minister Decree and a BOL implementation regulation have been issued yet active supervision has not yet been taken up and nor have supporting supervision procedures, systems and manuals yet been created.

249. **Leasing and Finance companies.** Leasing and finance companies involved mainly of financing of household appliances and vehicles. Supervision could help protect consumers and prevent financial crimes, mainly money-laundering. A complete regulatory and supervisory system is not yet in place and the FISD has only recently taken over this responsibility from the BSFD.

250. **LPFI.** The LPFI is currently being supervised as if it was a DT MFI, yet has features specific for Postal Service providers which warrant a separate regime.

251. **Licensed MFIs.** For licensed MF providers a thorough supervisory framework has been set up, including regulations with prescriptions for prudential organizational structure and ratios, Chart of Accounts, licensing procedure, checklist, reporting formats and an adequate supervision manual, and has been supported by ample training of staff and TA (also: Flaming 2010).

252. **Conclusion NBFI supervision framework.** The supervisory framework is largely in place for MFIs only. For other NBFIs, despite key supervisory issues being at stake including which significantly protection of RMF customers, gaps exist which should be filled. In the paragraph below we will have a look at the supervisors.

253. **NBFI supervisors.** In the meantime, a core-group of some 14 staff has up to four years of experience working in MFI supervision. Challenges remain. First, there is the extension of the portfolio with new types of institutions on which knowledge and experience regarding regulatory and supervisory issues should increase and for which a framework should be developed. Secondly, the number of MFIs and other NBFIs has grown strongly while the existing workload caused by MFIs only was already filing up the schedules of staff. Recently, in order to cope with the extended workload, a total of 19 new freshly graduated staff has been hired which need to be educated from scratch. Simultaneously, the four BOL branches have taken over responsibility for supervisory tasks which has added the issues of coordination and organizational priority in supervision between head office and branch offices. The latter needs additional clarification to assure an effective and efficient way of working and consistent supervisory policies, findings and decisions. Existing experienced staff needs for hands-on, on-the-job technical support and back-up, based on their concrete questions and needs for technical support. Questions and needs experienced FISD staff have relate to core issues, such as the purpose of supervision, the roles each of the division play and how the various divisions should communicate, coordinate and cooperate. Examples are questions such as who should initiate or lead the supervisory process, who should address results of an inspection report and an off-site analysis, and who should be addressed, what consequences of made observations should be, when to enforce, how and by whom. Supervision is mainly compliance based and MFIs are predominantly treated in a similar way regardless of risks, size, strength of internal organizations and control, and financial

strength. Some MFIs have been in operation for many years without meeting prudential ratios and criteria embedded in the MF regulations. And, because of overwhelmingly available donor support for microfinance, the FISD has been overloaded with development projects all aimed at supporting a small group of formal MFIs and their supervisors in the FISD, too often without adequate assessment of the needs of the FISD and the RMF sector as a whole or sometimes even without an open attitude towards these needs.

254. **Suggestions FISD supervision: strategy.** A strategy should be developed for NBFI supervision, assisted by a financial sector supervision specialist and based on an adequate sector assessment.[235] The strategy should build on recently issued "Guidelines on Microfinance activities and the Core Principles for Effective Banking Supervision" by the Basel Committee on Banking Supervision yet should be embedded in the specific setting of the Lao PDR. It should map FISD's portfolio of responsibilities in terms of amount and types of risk, and in terms of key objectives of supervision, both prudential and non-prudential. Before finalization and implementation of the strategy, it should be assured there is full understanding of key supervisory objectives and risks involved over the spectrum of NBFIs. This assessment should be the basis for weighed prioritization of supervisory needs, planning of activities and consequential development needs, including the need for human resources in terms of number of staff and required TA. The resulting development needs should be put on a timeline, including definition of milestones and expected outcomes. The development of the strategy should be done with full ownership of the FISD management, whose active participation and leadership are crucial, and who should be responsible for both the development and implementation of the strategy. The planning of responsibilities, activities and needed resources should be done at the level of the four divisions as well as overall, and should include the BOL branches. Human resource development should be made an integral element of the strategy and should receive specific attention.

255. **Human resource and its development.** RMF sector development and supervision are highly human-capital intensive, and in effect make human capacity development of crucial importance. BOL has made strong improvement in Human Resource Development over the last five years and the traditional system of rotating staff has been moderated. From the FISD supervisory strategy mentioned in the previous paragraph normally a planning of the needed number of staff and their required competencies should follow. These required capacities should be determined and described to make explicit, detailed job descriptions. Recruitment and selection should be based on the FISD's needed capacities and the tasks and responsibilities embedded in the job descriptions, and should be related to training and development programs. Staff should be selected, recruited and trained aimed at fulfilling their job descriptions. In building a structure of job descriptions, both the jobs and the seniority within the job should be graded in various levels, with additional reward attached to reaching a higher level. Based on job descriptions and agreed upon targets, performance should be regularly and systematically evaluated based on objective criteria related to performance and in an objective, verifiable manner. As

[235] This sector assessment might even play a role. The paragraphs on the FISD and on NBFI supervision are relevant to RMF development only in as far as NBFIs are involved in RMF delivery. After inception it was agreed by the government and ADB to include both issues.

required by Law, all of the above must be codified and made explicit in an employment contract.[236]

256. **Contract and code of conduct.** Codifying the employment relation in a contract serves another important purpose. BOL and the FISD have a specific, important position with due responsibility for building a reliable financial sector and protecting its customers. BOL interventions can have significant consequences for financial service providers and their customers, and enforcement or lack of it could potentially or at least theoretically lead to liability. To be able to do supervisory work without obstruction, supervisors should be protected from liability based on their supervisory work, which should be made explicit in their employment contract, backed up by Law. The importance of the position of BOL as financial regulator and supervisor also brings with it the need for the public to be absolutely sure of the independence and objectivity of BOL and its staff. As customary for Central Banks, staff and management should sign a Code of Conduct aimed at preventing conflicting interests, with explicit consequences for non-compliance.

2.10 Semi-formal providers: village-managed loan funds

257. **Village-managed loan funds.** The VMLFs in the Lao PDR are both unknown and underestimated as RMF provider, despite their ubiquitous presence and outreach in terms of number of members, "savers" and borrowers.[237] The fact that they are less known might be the consequence of a number of reasons. VMLFs have been initiated since the 1990s as in a parallel universe, outside the scope of BOL and disconnected from the formal sector. This while both BOL and the formal financial sector are the natural counterparts for development organizations working on financial sector development, for investors and for commercial lenders. Secondly, there are many different parts of the mass organizations and the government, as well as an array of different development organizations that have initiated VMLFs, on the basis of various sets of guidelines and different program designs. Programs are often implemented in isolation, stand-alone, and as a consequence it is not easy to get a complete overview. Finally, critical analyses are scarce and evaluations or lessons learned are often not shared or made public; also on VMLFs, publicly available information is lacking both in quantity and quality.[238]

258. **VSLFs**. As seen earlier, long-term specialized TA and member ownership through internal, member funding are crucial success factors for VMLFs. Both features are present in VSLFs which renders them relevant RMF providers. On VSLFs' socio-economic contribution Sengsourivong (2006) finds positive results for their members in "household house value, household livestock production income,

[236] Labor Law of the Lao PDR (06/NA, 27/12/2006), article 3.1

[237] In Laos, for most people, including many senior political decision makers, the concept of microfinance is synonymous with "village development funds", which the expression most commonly used for VMLFs.

[238] One exception is the publication of the so-called "National Rural and Microfinance Statistics" (2003-2006 and 2009) by NERI, part of MPI. The report gives predominantly quantitative information due to the specifics of the mandate of their research assignment and constraints posed by limited budget and staff. Additional in-depth analyses of methods and results have the potential to add valuable insights.

household agriculture production income, household rental expenses, and household education", in an in-depth study on 6 VSLFs in semi-urban setting in Vientiane Capital. Coleman (2006, Elsevier) studying VMLFs in Lao Isaan finds they are vulnerable to be "taken over" by powerful people in a village, including village authorities, who are prone to receive most of the benefits from the fund and who are often found as committee members according to his study. In a recent study initially aimed at the 40 largest VSLFs in Vientiane Capital's Xaithany District, which has been extended to include information of over 91% of all VSLFs in Vientiane Capital, Seibel (2010) finds their strengths are cultural integration, outreach, self-governance, financial self-reliance, cost effectiveness, profitability and demand-driven products. Seibel finds weaknesses in the design of the accounting system, in the low capital formation, in the (sometimes a bit too relaxed attitude towards) delays in repayment and in the low rate of transactions (often only once a month). The VSLFs have developed their own informal support networks, which provide both TA as well as monitoring and supervisory services. The networks are formed by elected key representatives of VSLFs on the initiative of the VSLFs. The VSLFs have come together in geographically oriented groups which constitute, manage, own and finance the network support group and elect its members (Seibel 2010).

259. **Conclusion and recommendation**: VSLFs are an important RMF provider yet have largely been ignored or gone unnoticed. Communication should be enhanced between BOL and the (instigators of the) VSLFs in order to build mutual understanding and coordinate efforts for the benefit of both. Both the VSLFs and the formal sector could be strengthened if VSLFs could be integrated in a way that benefits the VSLFs, their member-customers and their committee members. For this to happen, open communication with key stakeholders should be initiated by BOL with the aim at creating mutual trust and understanding in a way that honors the Lao cultural and political setting. Various options exist for the way forward which ultimately depends on ownership and bottom-up support by the VSLFs and their stakeholders. Crucial is the ability to adapt regulations and supervision to practical reality of the VSLFs, their needs and their network support organizations. The existing SCU regulation might be adapted to include the VSLF practice of having two committees and build on existing VSLF Guidelines issued by the LWU. Looking ahead, for the future it should be considered if the network support organizations could be involved in delegated supervision. Formalization is relevant, as it opens the way to better governance, would facilitate relations with other financial institutions (e.g. banks) and development organizations, which could ultimately benefit the VSLFs themselves. ADB could be instrumental in facilitating this process

260. **VRLFs**. At the far end of the spectrum of VMLFs, VRLFs are simply used as distribution channel for cheap donor funding using the outreach of the networks of mass organization and government structures to reach poor, rural villages. From a perspective of building sustainable RMF providers they have little added value and in fact can undermine efforts towards that goal. As we have seen, the poorest households almost exclusively want to borrow for emergency reasons. Their economic opportunities are more determined by market access, infrastructure and access to production factors (e.g. education) and will not be the result of supplying inexpensive loans. Several evaluations of rural development projects with a credit component show it is often difficult to disburse funds if criteria such as the need for a "business plan" or "use for productive opportunities" are too strictly adhered to. A

related finding is that the funds themselves are sometimes a reason to join a program, rather than the rural development objective of the program (e.g. improved livestock management) or an economic opportunity. Put RMF systems building aside and the programs show features that in the short term have the potential to make all involved happy. Completion of a project and full disbursement of funds is a crucial success parameter for most development projects. After project completion the funds stay in the village and often stop revolving. As record keeping, governance structures and transparency are not key features of these programs it is often hard to establish where the funds end up. This situation is facilitated by fact that the governance structures of VRLF components of development programs often not clearly define who can be considered owner of the funds; the individual villagers, the village as a whole, village authorities or higher-level authorities. As a consequence, VRLFs are often seen as "quasi grants" by all stakeholders involved.

261. **Not suitable for Hydropower and Mining companies.** For the reasons of the lack of clear governance and ownership (in the literal meaning of the word), and because of the observations made by Coleman (2006 Elsevier) and others that powerful local people are able to skim benefits their way, the VMLF model is less suitable for programs that mining and hydropower companies have to design in order to compensate villagers for loss of livelihood or to support the livelihoods of affected villagers, unless strict safety measures can be designed and implemented.

262. **If we put aside RMF sector building: do they actually work?** Regarding program-loans to poor villagers in such a program, if the stated objective (e.g. a successful live-stock management business) has failed, it is socially hardly acceptable to ask liquidation of assets (if available) for repayment or continue the loan. After all the villagers are poor and it is the program that has failed to deliver its promise. Although VRLFs often do not create lasting outcomes, temporary improvements in wealth (e.g. increased livestock holdings) can be witnessed and "borrowed" funds can be used for other purposes, such as paying for children's education, repaying another loan or for emergency reasons. Indeed, as shown by a recent study on VRLFs in Lao Isaan, "village funds reach the target groups of households with a lower socio-economic status to a higher degree than competing institutions from the formal sector, provide loans to those kinds of borrowers which are more typical customers of informal than formal financial institutions and help to reduce credit constraints. However, they do so to a quite limited degree, questioning their efficiency" (Menkhof 2009). Coleman (2006 Elsevier) and others identify the issue of the local powerful people being able to absorb the low-interest rate loans and have even been reported to on-lend the funds to villagers using higher interest rates or use the funds to save in VSLFs.

263. **VRLFs in Laos' practice: anecdotal.** Still, in areas with market access, villages with a sense of "ownership" within local authorities and villagers, with strong local authorities, knowledgeable on administration and rural economics, funds have been reported to revolve to some extent by various project managers. Indeed, the distinction made earlier in the report between VSLFs and VRLFs and their successrate is one used to model reality, the latter which is more diffuse. The distinction does however support overall analysis based on key success criteria. In various ways (e.g. creating apex-like associations based on semi-formal bylaws, building a formal district-based SCU encompassing a number of VMLFs) and by

different development organizations (e.g. ADB, GIZ, Lux Development with IFAD, GIZ-AFP) trail and error attempts are being made to find an “exit-strategy” or a solution for the requirement of sustainability, until so far with the burden of proof against the organizations involved.

264. **Conclusion and recommendation**: Since VRLF can hardly be described to be demand driven or effective, since they lead to rent-seeking behavior by the powerful and to allocation of resources to unproductive activities, while undermining financial systems development and the focus on value creation and economic growth they should not be supported and in fact be discouraged, both within ADB and within the government. The issue should be addressed at the right platform, where decisions on subsidized interest lending as a broad policy measure are made. Within ADB the issue should be addressed in departments responsible for rural development programs in Laos.

2.11 Private insurance

265. **Private insurance.** There is no clearly defined policy or strategy for the development of the private insurance sector.[239] In general terms, there are stated objectives to pursue and challenges met, such as improving the regulatory and supervising framework, promoting good governance, building the capacity of the regulators, developing the financial infrastructure and liberalizing the sector (interviews MOF 2011; Lomany 2009; NSEDP 2006). Interestingly, two specific strategic objectives for development of the private-insurance sector have been embedded in the 6th NSEDP (2006-2010) which are highly relevant for low-income and rural households; the development of agricultural insurance products and of consumer protection.

266. **Broad range of identified constraints.** In a recent assessment of the private insurance sector a multitude of issues in need of approval have been identified. There is a lack of publicly available information on both demand and supply side, existing regulations are outdated, there is a lack of human and technical capacity within the supervisory authority, there is a too little coordination and exchange of information between the various financial sector authorities, there is a lack of supervisory procedures and practice, and a lack of consumer protection (Lord 2010). Even existing compulsory insurance, in particular third-party liability insurance for motor vehicles is not being bought but by a small group of car owners, while enforcement of the related law is absent yet technically easy. The Insurance Law has been under review for a few years now. The review was intended to address over 100 specific regulatory issues in need of being solved, which had been identified in an assessment made jointly by the government and the private sector. Recently, a steering committee has been set-up to bring the regulatory environment up to international standards, specifically the standards defined in the setting of ASEAN and the WTO.

267. **Insurance sector framework increasingly determined in ASEAN and WTO.** As seen earlier, the priorities and structures that determine the private

[239] The relevance of the FIDS-2020 for the insurance sector is unclear. Although the FIDS-2020 states coordination has taken place it doesn't state with whom and on what issues. The FIDS-2020 has no separate chapter on insurance and is the responsibility of MOF, while the FIDS-2020 has been produced by BOL. During the meeting with the staff of the division in MOF responsible for regulating and supervising the insurance sector, they indicated they were not aware of the existence or content of the FIDS-2020.

insurance sector and its development are increasingly being decided on in the setting of ASEAN and the WTO. In particular the agreements been made on liberalization of trade in services, including financial services, as part of ASEAN have direct consequences for the Lao PDR. It for this reason that the ASEAN Division of the Fiscal Policy Department of MOF has been made responsible for regulatory and supervisory issues regarding the private insurance. The division has five staff and is primarily responsible for issues related to ASEAN economic integration, in as far as they relate to MOF's responsibilities within the Lao PDR government framework. The division is not specifically set-up or equipped to regulate and supervise the private insurance sector, and its staff does not have any specific educational background or experience in the subject of insurance but for some unspecified training courses.

268. **Main constraint is lack of demand.** Despite all the issues mentioned, the main constraint for increased provision of private-insurance services is the apparent lack of demand (Lord 2010), confusingly in a setting where risk management is a main priority, in particular for low-income and rural households. Specific, concrete information on the causes of the gap between actual demand and (inferred) potential demand for insurance is lacking. Ample anecdotal "evidence" points to the lack of understanding and acceptance of the concept of insurance combined with a lack of information and consequential awareness or even interest amongst all stakeholders, potential clients, including the management of financial institutions, policy makers and implementers.[240]

269. **Summary and conclusions.** There is a range of issues to be dealt with in order to develop the market for private insurance. First priority is to do more in-depth analysis of the causes for the apparent lack of demand and of the lack of interest within the other groups of possible stakeholders, in particular banks. In terms of RMF development there is a need to undertake a study of the feasibility aspects of setting up the systems needed to provide agricultural insurance, in particular related to the main staple, the main commercial crops (rice, maize) and livestock. The study should deal with the main risks for rural households, such as flooding, drought, cold weather, disease, and pests, and should include the feasibility of risk-management and risk-mitigation measures. For implementation of compulsory third-party liability insurance for drivers and owners of motor vehicles, which also affects low-income households, increased high-level political support is needed.

2.12 Social insurance

270. **Social-security organization.** The social-security system has been steadily growing following the legal obligation for large companies to insure their staff.

[240] Some examples may serve to illustrate: As part of a recently introduced APB loan product motorbikes were introduced as collateral. The related proposed obligation for borrowers to take out insurance as a requirement for eligibility for a loan was however dismissed. In the Finance Working Group of the Lao Business Forum the issue of the lack of enforcement of compulsory third-party liability insurance by the police, has been brought forward by the private insurance sector representatives. Also for insurance products that are easy to design and to market, such as personal accident insurance, so far little interest has been shown by financial service providers to leverage their existing branch network for the potentially rewarding strategy of cross-selling.

Following coverage of the largest companies, the obligation was extended to include companies employing over nine staff. As seen earlier, despite the obligation, the number of companies participating as a percentage of the total can still be considered low and the SSO has little means of enforcement. Sometimes the interests of other parts of the government, in particular of the tax department and of the SSO, can diverge. Companies are known to stay small or at least informal, including those that in reality have over nine staff, in order to avoid the burden of taxation and administrative requirements. As part of this strategy of staying informal, companies hesitate to become a member of SSO. Companies have been observed to formally dissolve and withdraw from the SSO following visits and phone calls from the tax department, as indeed the information about the companies was supplied by the SSO to the tax department on the latter's request.[241] The SSO is operating well and its main strategic objective is to enlarge participation.

271. **Summary and conclusion.** To deal with the situation mentioned in the last paragraph and in order to protect the often low-income, socio-economically vulnerable workers, the SSO should be released of the obligation to supply information to the tax department. Unfair taxation practices and burdensome administrative procedures for formal companies have to be dealt with. At the same time, the SSO needs to be strengthened and supported in their awareness raising and marketing efforts through publicity campaigns, possibly in cooperation with the Lao Federation of Trade Unions.

272. **Health Insurance.** Although health insurance in someway is somewhat on the outskirts of the scope of this assessment and it is handled by a different department in ADB, it is a central issue for low-income and rural households. Moreover, outreach and success of health insurance provision are directly related to the state of development of the financial sector and to the extent to which it reaches out to the RMF segment. A main constraint for development of the health-insurance sector is found in the lacking facilities for those insured to make the regular payments of insurance premiums at low cost. Development of the payment system in terms of facilitating low-income people's inclusion in the formal financial sector by creating low-threshold access to payment accounts, by extending outreach of cash-in cash-out outlets of financial service providers, by allowing agents to be included in the facilitation of payments, combined with leveraging their effectiveness by enabling the use of IT facilities, including mobile-phone based technology, would take away a main constraint for development of the health-insurance system.

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[241] The phenomenon of dissolving a company or sometimes just only re-registering under a different name by the same legal entity or household was also reported by banks, as a way in which borrowers try to forego loan repayment.

3 Infrastructure constraints and development issues

3.1 Financial reporting, accounting and auditing

273. **Framework.** The regulatory and institutional framework, and the implementation and practices related to financial reporting and auditing have ample room for improvement, both those related to financial service providers and those related to (micro) enterprises.

274. **Lao Accounting Standards.** This observation has been most clearly summarized in a recently undertaken assessment by the World Bank and IMF: *"Lao Accounting Standards (LAS) compliant financial statements do not comply with some of the most basic requirements of modern accounting and financial reporting; the information they contain are hardly useful for decision making by market participants"* (WB and IMF 2009). Banks and insurance companies are currently not required to use International Financial Reporting Standards and to accommodate this situation accountants add a cautionary clause to their certification of the financial reports of companies they have audited.[242]

275. **Very few companies are audited, or make or issue a financial report.** In Lao practice very few financial statements are audited. The percentage of companies that have an actual accounting system in place could be as low as 10%, as estimated by the Lao Minister of Finance Mr Somdy 'Douangdy in 2010. During the same speech the Minister made a public statement about the need to strengthen accounting and auditing practices, and explicitly added to say that not all audits are done fairly and are too often aimed at tax evasion.

276. **Challenges accounting standards.** WB and IMF (2009) have analyzed that challenges are multifold. They explain that the newly adopted auditing and accounting are descriptive and in need of clarification, that various laws covering auditing and accounting issues are inconsistent, that there is a lack of qualified Certified Public Accountants and of a well-functioning accountants organization, and that the designated authorities, among which BOL's Supervision and Accounting Departments and similar department at MOF, lack the necessary technical capacity (WB and IMF 2009, page 20).

277. **Accounting and taxation for micro and small enterprises.** Looking at enterprises, they consider the administrative, accounting and reporting requirements for micro enterprises and SMEs to be burdensome and as a consequence smaller enterprises hardly comply. Most negotiate the tax obligation at District level and claim low revenue. Since the tax liability is based on presumptions and is negotiated, not measured, there is no strict need for using a "real" bookkeeping or accounting system. The result is a circular situation in which those who are directly involved benefit. Complying with accounting, auditing and reporting requirements is considered burdensome by micro and small enterprises. As long as the negotiated tax

[242] "The accompanying financial statements are not intended to present the financial position and results of operations in accordance with the accounting principles and practices generally accepted in countries and jurisdictions other than the Lao PDR".

liability is lower than the sum of the real tax liability and costs caused by accounting and reporting requirements the micro enterprise is better of. The consequential lack of transparency also benefits the tax collector who can be paid under the table. As a result bookkeeping, reporting and transparency continue to lag. The resulting lack of reliable financial information puts the burden of the assessment of the financial capacity of a (micro) enterprise on the financial service provider, adding to cost and risk of financial intermediation. As a consequence of the fact that enterprises (have to) stay small and informal to avoid unfair and burdensome taxation, micro enterprises forego the benefits of larger scale operations, increased effectiveness and efficiency. Exactly these issues, of increased efficiency and effectiveness, are crucial for the successful development of the economy of the Lao PDR. From this it follows logically that the creation of simplified accounting and reporting standards, and a simplified, less burdensome tax filing system for household-based, micro and small enterprises, based on true income and expenditures, are of crucial importance for the development of the Lao economy overall, and for income and employment of low-income and rural households in particular.[243]

278. **Summary and conclusion.** Good-quality accounting, reporting and disclosure regulations, and practices, are crucial for risk management and confidence in both the financial sector overall and in individual financial service providers, including those providing RMF services. Since reforming the related governing framework and building the capacity of both authorities and practitioners takes a long time, while in the meantime the financial sector has already been liberalized and as a consequence is expanding rapidly, it is imperative to start the necessary reforms sooner rather than later. Similarly, to break the circle of micro enterprises staying microscopic, the current administrative, accounting and taxation framework for houshold, micro and small enterprises should be reformed as soon as possible.

3.2 Consumer protection and financial literacy

279. **General measures protecting consumers theoretically exist but enforcement is needed.** Issues related to general measures of consumer protection are elaborated on in other parts of this paper, when the need for transparency, information provision, improved reporting standards, promotion of a level playing field and fair competition are addressed. Disclosure requirements for financial service providers, such as the one for banks publishing annual reports, are however hardly followed and not enforced. The general institutionalized setting aimed at creating a sound financial sector and instilling trust in the customer base is still in a stage of early development.

280. **Specific measures of consumer protection are basic.** Currently consumer protection is limited to a lowly developed depositor protection system (see paragraph 3.3 below) and some measures that can be found scattered in articles of different regulations. Membership of the depositor protection system is compulsory for commercial banks and for licensed MFIs yet only banks have become actual

[243] Very recently a serious debate has taken place in the National Assembly on exactly this issue, indicative of its urgency, during which the National Assembly requested the government to adapt the system as described. The government indicated it is not yet able to change the system but acknowledged the need.

members, most of which over the last two years. The Law on Commercial Banks contains articles on information provision related to deposits and their withdrawal, and on protecting the privacy in case of electronic banking. On pawn shops articles in the Prime Minister Decree and in the BOL instruction on Pawn Shops contain rules regarding maximum interest rates, a description of objects that can be used as pawns and requirements that should be met before a pawned object can be sold. Finally, an article in BOL's Microfinance regulations contains minimum requirements regarding the provision of information on loan products to prospective borrowers. Interestingly, the 6th NSEDP (2006-2010) has mentioned consumer protection in the private insurance sector as a priority, but no measures designed to work towards achieving this objective could be identified during this assessment.

281. **Consumer protection is increasingly needed.** At the same time, because of the rapid expansion of the different types of financial services (e.g. leasing, debit and credit cards, ATM's, new deposit products, mobile-phone banking), the number of providers and the number of customers, there is an increasing need for consumer protection. The setting of a lowly developed legal system combined with often lacking explicit contracts, detailed and in writing or sometimes at all, between financial service providers and their customers concerning liability and course of action in case of problems makes for a situation that should be urgently dealt with.[244]

282. **Direct consumer protection including a responsible agency is lacking.** Still, consumer protection needs to be more directly targeted. In Laos there is no specific regulation on consumer protection, no institutionalized method to help resolve conflicts other than the normal court system nor any activities aimed at raising awareness or the level of skills for people to be able to manage their finances. There is no regulatory provision to designate a special institution or department with the responsibility to protection consumers or to resolve conflicts.

283. **Financial literacy.** The general level of education is low, in particular in the rural areas. Sporadic evidence, for example found in discussion groups of development workers in the rural and agricultural sector, indicates that the lack of the ability to do simple planning exercises and make simple calculations are factors causing Lao farmers to end-up in distress. Similarly, in various reports on the effects of commercialization of agriculture such as those on contract farming, indications can be found suggesting that the lack of understanding of intricacies of a contract, including implied financial costs and benefits, is a main risk factor for farmers.

284. **Summary and conclusion.** The general low level of education, the rapid commercialization and increased monetization of Lao society, and the low level of consumer protection combined make RMF customers vulnerable for abuse of the information and awareness asymmetry between them and financial service providers. In an increasingly market-oriented society in which informed economic decision making and planning becomes increasingly important there is a strong need for increased financial literacy and awareness.

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[244] There are anecdotal stories circulating in Vientiane and sometimes in online media, on how things went wrong during use of some financial products and how the customer was the one affected. Even if the stories are mere rumors, they affect trust in the financial sector and are indicative of a need for improved consumer protection.

3.3 Depositor protection

285. **Saving, monetary savings and their importance.** Just as Asia as a whole, the Lao PDR has ample available savings within its population. The combination of a lack of financial sector outreach and a lack of trust within the population has seen the formal financial sector play a relatively minor role in absorbing savings, as indicated by low ratios of deposits to GDP.[245] Rural and low-income households in particular maintain savings in cash, gold and for the most in livestock. This, despite the fact that hoarding livestock as a way to store wealth is subject to high risk, high transaction costs and high illiquidity.[246] When weighing costs and benefits of the various available ways to save, monetary saving in formal financial institutions could be preferred if transaction costs would be low and the deposits made would be safe from inflation and non-repayment. Assessing these costs and risks, it can be observed that, by and large, inflation is under control and has been for over a decade, and it is possible to make a positive nett return on savings in Laos. Transaction costs created by physical distance to a financial sector outlet and travel still play a significant role, in particular in the rural areas and they go partly to explain the success of VSLFs. The risk of non-repayment has historically been considered large and could be reduced by a well functioning deposit protection system.

286. **Potential for formal sector's added value to saving.** Protection of deposits made in the formal sector would give formal financial institutions an advantage over VSLFs, since as we have seen "savings" made in VSLFs actually are risk-baring member share capital.[247] On top of this, the possibility of non-repayment of deposits made in VSLFs is augmented if compared to saving in banks, because lending by VSLFs is limited to the village in which the contributions have been generated or, in other words, the related covariance risk can not be diversified away. As people in the RMF segment have little leverage in income and capital, and use saving as a strategy to cope with socio-economic shock and income seasonality often directly related to food security, their required risk premium is high. The ability to secure deposits, however small in absolute terms, through a well functioning deposit protection system would have huge added value for low-income households.

287. **Savings and their added value to the formal sector.** Over the last five years we have seen more aggressive lending strategies emerge in the banking sector, as a consequence of government instructions to support the growth of the "real" economy and of the entrance of a significant number of newly established privately-owned banks and consequential competition for market share. Overall, the lending growth rate was substantially higher than the deposit growth rate and the overall loan-to-deposit ratio has sharply increased. The competition for deposits in the financial sector and in particular for deposits in kip is competition for a low-cost source of

[245] In the recent past, large parts of the population in the Lao PDR have had bad experiences with depositing money in formal institutions, in particular just after the liberation of Laos in 1975 during the era of cooperative organization of the production process (insolvency of credit cooperatives) and later during the Asian financial crisis of 1997-1999 (inflation, evaporation of the value of the kip).

[246] Recently, large numbers of livestock have died in Laos due to bad weather and disease. Anecdotal evidence indicates steep discounts of 50% of a normal market value of a buffalo when it is being sold in case of an emergency.

[247] Which as we have seen earlier have relative large outreach in the RMF segment.

funding. Seen from this perspective, the ability to generate deposits creates leverage to extent outreach in lending, to lower lending rates or to generate more profit. At the same time competition for depositors can be a marketing strategy. A customer that saves develops a relationship with its financial service provider and is more susceptible to using other financial services delivered by his provider. For APB (and LDB for that matter), generating deposits from the public is particularly important as it lacks access to (international) capital markets. Strong deposit protection would support the formal financial sector as a whole, and APB in particular, to attract ample, low-cost funding. It would also serve to support integration of customers, and in particular low-income households, in the formal financial sector by lowering their risk of non-repayment by protected financial service providers.

288. **Savings in the formal sector and the added value to the economy.** A well functioning financial sector channels surplus funds from the inactive part of the population to productive entities and allocates the funds to the most productive activities in need of funding. Absorption of deposits in the formal financial sector thus stimulates production and provides a reward (interest) to households which without financial intermediation they would miss out on.

289. **Depositor protection and its added value.** Concluding, for the near or mid-term future, having a strong depositor protection system would help achieve a number of important goals:

1. It would provide RMF clients with the security they need in order to use a safe and liquid facility to create a buffer, match income and expenditures, build wealth and fund productive activities
2. It would help financial service providers to access a low-cost and stable source of funding
3. As a consequence, it would facilitate making productive use of excess funds in Laos, fuelling growth of the Lao economy by transforming time, amount, place and duration of funds and providing a reward for holders of idle funds.

290. **Depositor protection is a priority in main policy and strategy documents.** The importance of generating more deposits has been acknowledged by the government and has been embedded in the 7th NSEDP. Strengthening the depositor protection system would support that objective and has been mentioned as a strategic goal in the FIDS-2020. With regard to exiting depositor protection, more will elaborated in the next paragraphs following immediately below.

291. **Depositors Protection Fund.** A formal Depositors Protection Fund (DPF) has been established in 1999 as a separate legal entity in the form of a state-owned enterprise, based on a regulation and charter issued by BOL.[248] [249] The DPF's stipulated aim is to "repay compensation to depositors of commercial banks in the

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[248] Established in 1999 based on a regulation issued by BOL (283/BOL, 30/08/1999), which was agreed upon by the MOF (1285/MOF, 23/09/1999). Further details were outlined in a Charter (03/DPF, 27/12/1999) that was issued by the DPF itself, in its role as part of BOL.

[249] Defining the DPF as an "enterprise" opens up the possibility, at least theoretically, of "profit".

Lao PDR in case of failure and create public confidence and insuring deposits made with commercial banks operating in the Lao PDR".[250]

292. **DPF: recent developments.** Until some two years ago, the DPF lead a modest, secluded existence. Only seven banks out of 20 had become the DPF's member despite the fact that a legal obligation to join had been in place for a decade.[251] During an interview held in 2011 the DPF management stated the DPF had only recently become "independent" even though the legal reality required it to be so since 1999. Recently, new management has been appointed and a more active approach has been adopted.[252] Since, all 24 commercial banks have joined the DPF and recently even licensed MFI and SCUs have been encouraged to apply while negotiations with the LPFI are ongoing. Remaining unfulfilled elements of DPF's Regulation and Charter are in the process of being implemented, an overall internal evaluation is underway and an action plan is in the making.

293. **DPF action plan.** As part of the action plan, the DPF intends to increase the dissemination of information between the DPF and its customers, set up a website, adopt a logo, build a new office and, importantly, improve existing regulations and practices.[253] The DPF's intention to improve the regulations and to strengthen implementation follow the specific priorities related to depositor protection that were set by the government and that have been detailed in the FIDS-2020. The FIDS-2020 explains the strategic objectives with regard to the depositor protection system are to make an analysis of the depositor's protection system using risk-based assessment, to develop new depositor protection products and to increase efficiency in the depositor protection system.[254] In line with the intended improvements, the DPF intends to alter its name to become "Lao Deposit Insurance".

294. **DPF: need to improve governance and make strategic plan**. Currently, the overall governance structure of the DPF is less than clear, with the possibility of conflicting standpoints or misunderstanding as to the question which agency's responsibility a certain issue is. Although both regulation and charter stipulate the DPF shall operate independently, its existence has been based on a BOL regulation which, at least theoretically, is reversible. Moreover, the DPF and its management are mentioned as part of BOL's management structure in BOL means of communication, leaving room for confusion over DPF's independence.[255] Until some two years ago, the DPF was located in the BOL's office and its staff's salaries were paid by BOL. BOL supervises the DPF through its FISD, outside the FISD's normal scope and without necessary specific background, knowledge or experience.[256] DPF also has a multi-dimensional relation with the MOF. DPF's capital is split in shares which are currently held by the MOF and which can be transferred to external parties only if

[250] Article 1 of the DPF Charter; see also article 1 of the DPF regulation.
[251] Article 6 of the DPF regulation, reiterated in article 5 of the Law on Commercial Banks (03/NA, 26/12/2006).
[252] 273/PMO (22/09/2009), pages 37 and 38.
[253] Interviews with DPF management on 8 August 2011 and by Vientiane Times on 29 July 2011.
[254] Financial Institution Development Strategy, page 37, 38.
[255] E.g. BOL's website, www.bol.gov.la, which has been recently adapted to changes in DPF's change of management, DPF senior management's official name cards and e-mail addresses.
[256] The DPF does not provide financial services directly to the public, and in as far as it does it provides a form of insurance or guarantee. The service it provides relates to banks,

agreed by MOF. New shares can be issued to both MOF and member banks.[257] MOF also has the jurisdiction to appoint and dismiss the DPF's Managing Director. The DPF's Managing Director is *"responsible to the Board of Directors for the administration and development of the DPF in accordance with the strategic goal and Business plan as approved by the Board"*.[258] The Board of Directors is the supreme body of the DPF and has been authorized to represent the interests of MOF's interests as shareholder of the DPF. The members of the Board of Directors are appointed by respectively the MIC, MOF and BOL, and include a representative of the SOCBs that has to be agreed upon by the MOF. The Board of Directors' members can also be dismissed by the MOF or by the Annual General Meeting, at the proposal of BOL's Governor. The Annual General Meeting consists of the Managing Director, Deputy Managing Director, the accounting inspector, shareholders and *"any other authorized person"*, without specification of who constitutes to be the accounting inspector or the other authorized person.[259] Although, in case the DPF lacks funds to compensate depositors, the necessary contributions should normally come from other banks, the banks hardly have any position in the DPF's decision making process. Privately-owned banks have no position in the DPFs decision making process at all.

295. **DPF: overall risk and contribution.** The total amount of deposits theoretically covered by the DPF could not be determined during this assessment, but the assets of the DPF are expectedly insufficient.[260] [261] [262] In case the DPF needs to compensate depositors in line with DPF regulations additional funding is needed, which has to be found in external borrowings or in extraordinary contributions from member banks. [263] [264] Currently no plan or set of rules exists to determine the possibly required contribution for each of the banks, or for the priority of external borrowings versus compulsory contributions by banks as a means of dealing with the funding gap. This situation has the potential to possibly raise problems. In case a bank is in distress questions could arise, such as how much each of the banks should contribute and why borrowing externally should not be employed first. The lack of a clear governance structure and the unclear respective responsibilities does not help to answer these questions. After the recent entry of a large number of privately-owned banks, rethinking the structure is advisable.

296. **The DPF's need for coverage and a strategic plan no. 2.** As it is, there are potentially conflicting interests between the various roles and stakes of the different

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[257] Article 5 DPF Charter.

[258] Article 14 DPF Charter

[259] Is it the administrator, internal auditor, external auditor or yet someone else?

[260] The total amount theoretically or legally covered by the DPF could not be found in any available publication. Needed information on deposit accounts in commercial banks has not been made available for this assessment.

[261] Indicative of the risk of non-repayment by banks and of the lack of information to assess it, is the fact that the capital adequacy ratio of both SOCBs APB and LDB is known to be insufficient by both Lao and international standards, while the capital adequacy ratios of other commercial banks can not be assessed because they do not publish annual financial reports, with the exception of two.

[262] Total deposits in the banking sector amount to $1,651 million, while total DPF's total assets amount to $5.5 million. Sources: BOL Financial Statistics 2nd quarter 2010 and interview with DPF.

[263] Including the issuance of bonds, see articles 4.1.5 of the DPF Charter and 4A.5 of the DPF regulation.

[264] Articles 5.5.2, 12 and 19 of the DPF Charter.

stakeholders. The MOF has a direct financial stake in the SOCBs, both as the administrator of the government's ownership and as the manager of the government's budget, while it also has roles as both shareholder and Board of Directors' member in the DPF. BOL has issued the regulation and charter of the DPF with form the basis of the DPF's existence. BOL also supervises both the DPF and the banks that are the DPF's members, has a close relationship with SOCBs and is simultaounsly responsible for a level playing field for all banks. Indeed, as indicated by DPF's management, it is not clear what the respective responsibilities are of MOF, BOL and DPF in case a bank can not repay its depositors and or which steps to take in that situations. This, despite the fact that preparation of a plan and a budget to prepare for the case of a bank's default is the central element to DPF's objectives and an explicit responsibility of DPF's management. A further indication of the need for rethinking and restructuring the DPF is the fact that no financial report so far has been able to be produced by the DPF.

297. **DPF coverage for a bank's individual clients.** Recently, the DPF has decided to extend coverage to funds deposited in kip, baht and US dollar. Maximum coverage is the cumulative of KN20 million, $1,000 and 30,000 baht per customer, per bank, yet after deducting any amount that the depositor owes the bank.[265] [266] No distinction is made between private or business depositors. Banks have to pay a regular fee of 0.1% on one-year basis of average deposits in kip, and only 0.025% on US dollar and baht, which has to be paid quarterly. DPF's total assets currently amount to KN44 billion and its registered capital stands at KN10.1 billion. DPF's assets, in line with the DPF charter, are predominantly held in the form of BOL and MOF bonds denominated in kip.[267]

298. **DPF: depositor protection and the public.** That a well-functioning DPF is not only of theoretical importance became clear again during the recent world financial crisis, when many banks all over the world collapsed. In Laos a bank run happened when rumors hit privately-owned Phongsavanh Bank in May 2010. On national television, PSB's namegiver and owner said: *"Phongsavanh Bank is covered by insurance under the Lao government for customers' protection. So if we don't have money, the national bank will pay"*.[268] Even though he might not have been completely correct with his statement, he may have given the necessity of strengthening the DPF an important pull by raising both awareness and expectations within the population. His remark and temporary funding assistance by BOL calmed the crowds and managed to stop the bank run. In the meantime PSB is again successful in the market for deposits, as it used to be, as stated by its representatives.

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[265] Article 13.3 of the DPF regulation. As we understand it, this would include due payments on a loan a depositor would have taken out from the same bank. For calculating customers this would discourage saving in and borrowing from the same bank.

[266] The DPF's charter still limits coverage to deposits in kip up to KN15 million, yet neither DPF regulation nor DPF charter have specific requirements for deciding and communicating insured amounts other than that the normal procedures for Board of Directors' decisions, majority voting and record keeping, as found in articles 10.7 and 11 of the DPF Charter.

[267] Source: Interview with DPF management and Vientiane Times, 29 July 2011. Part of the available assets are in low interest loans to APB, increasing risk and at odds with both DPF Regulation and Charter, as well with the rule for a level playing field for commercial banks, which has been embedded in the Law on Commercial Banks.

[268] Vientiane Times, 28 May 2010

Surprisingy, no commercial bank has posted a certificate of its membership of the DPF or announced the amounts insured by the DPF, despite the obligation to do so and despite the obvious advantages.[269] [270]

299. **DPF: current capacity and the future.** DPF's management indicated both the need for improvement of the DPF's institutional capacity and its openness to receive TA. The DPF has 20 staff, 11 of which have only recently joined. Knowledge and experience, both in breadth and in depth, are lacking. The DPF is well placed to increase confidence in the Lao formal financial sector and lower the required risk premium for consumers. It would thus facilitate access to lower costs funding for financial institutions, which would enable lower lending rates. Significant for the RMF segment, it would provide customers the necessary security and a reward on their currently idle funds. The DPF currently receives no assistance, while it is at a stage of developing a strategic plan on an issue which has been designated a priority for financial institution development by the government.

300. **Deposit protection needs strong financial institutions first**. However, the best protection of deposits and first line of defence is keeping deposit taking institutions strong and healthy. This requires strong overall institutional capacity, quality credit assessment by well-trained credit officers, a well designed and strictly implemented internal control system supported by a good-quality MIS system, and last but not least, strict financial sector supervision.

301. **Summary and conclusion.** Saving is a main need for RMF customers. In the current setting with macroeconomic stability, moderate consumer price inflation, a rising external value of the kip and an extending financial sector, there are numerous reasons to support savings mobilization. Depositor protection can play a significant role in providing overall confidence in the financial sector. By installing confidence, it can invite deposit making, lower funding costs and intermediate savings to productive activities. It is also a priority of the government. The first line of protection for deposits however is still building strong financial service providers. Building institutional capacity in financial service providers, including internal control measures, and improving financial sector supervision should take priority. Deposit protection should be pursued but should be limited to smaller amounts in kip and possibly baht, in order to serve RMF customers and invite their financial sector participation.

3.4 Credit Information Bureau.

302. **Credit Information Bureau (CIB): Setting and relevance.** For a financial sector that operates in a legal setting that renders the ability to effectuate titles of collateral uncertain, making an accurate assessment of borrowers' capacity and willingness to repay becomes ever so more important. Easy, fast, inexpensive access to good quality information on a prospective borrower's total outstanding existing financial obligations and repayment history are an effective way of reducing

[269] Article 16.3 of the Charter DPF.

[270] Few banks asked for the purpose of this report were not able to tell the right amounts covered or the rules determining coverage.

transaction costs and risks of lending. The relevance of adequate information on customers that lack relevant collateral, which for the most part are low-income and rural household, is even more pregnant. Over the last 4 year a strongly increased number of loans have been issued by various providers, mainly in the four main "urban" areas. As a consequence, the chance of someone in need of funds borrowing from more than one source is real, only adding to the relevance of the information provided by the CIB.

303. **CIB background.** Until recently, the delivery of easily assessable, reliable and complete creditor information was lacking. The only existing CIB, a separate division of BOL's BSD, used to run a fax-based system operated by the division's staff that was only available to banks. In case a prospective borrower applied for a loan of over $3,000 the bank where the application was made could send a request for information to the CIB, which in its turn then requested information from all other banks on the prospective borrower's existing obligations. The procedure was time consuming and could sometimes take up to two weeks to be completed, while the information delivered was of limited use.

304. **CIB: recent developments.** In the meantime, supported in a joint effort by ADB, EU and IFC, a process to upgrade the CIB is almost completed. A new charter for the CIB has been drafted which next to banks includes NBFIs, among which MFIs. The system is directly accessible, online, for banks and in the future, if the technology allows and if the regulation has been adapted, for NBFIs. The intention is to fill the CIB with information on loans of all sizes and to include all existing loans outstanding in the banking sector, creating a unique database with theoretically complete information.[271]

305. **CIB ongoing development.** The pilot to test the new system of the CIB involved all existing banks and has been a success, according to the consultants working on the project. Although future inclusion of formal MFIs is intended, the consultants analyzed that the low level of IT proficiency and automation of MFIs would create the need for the development of a special interface or manual support system. Consultants for a GIZ implemented project that looked at the technical aspects of inclusion of MFIs in the CIB advised to wait with doing an assessment of the feasibility aspects until the CIB will have successfully operated for at least 6 months.

306. **Conclusion CIB: information RMF segment limited due to prevalence of VMLFs and informal finance.** In reality, even if information on all outstanding loans in the banking sector has been included, the CIB's database will not be complete. Semi-formal providers and informal money lenders are main loan providers and by definition operate outside the scope of the financial authorities.[272] As a consequence, separate assessment of financial capacity and character as part of the loan appraisal process remain crucial and should be prioritized in terms of RMF development. The newly developed online credit information system of the CIB is an

[271] Checking whether or not information on all loans has been entered into the system is not part of the mandate of the consultants working on the project.
[272] Additionally, companies that finance objects such as vehicles and electrical appliances in the form of supplier credit should also be included if the database were to be complete.

important improvement for the financial secor overall, but will be of limited value for financial service providers operating in the RMF segment for some time to come.

3.5 Payment system

307. **Interbank settlement.** As analyzed above, there is a strong need for increased financial connectivity. The payment system in its narrow definition, in terms of a system to transfer funds between financial institutions, is an important element of overall financial connectivity and of efficiency of the financial sector. Recently BOL has initiated the proces of building and implementing a new technical system to improve interbank clearing of payments. This system will allow for real-time gross settlement and for instantaneous transfer of funds, and will function as an automatic clearing house.

308. **Only if CORE banking system.** When the system is operative banks with well-functioning CORE banking systems can link up with it and will be able to provide more payments more effectively and efficiently. As a consequence, for Lao people it will become increasingly interesting to make payments using the banking system, to make non-cash payments and to open banks accounts, as payments can be made more easily, at lower cost, faster and more conveniently.

309. **Payment system: Responsibility BOL and priority in finance sector policy and strategy.** The Law and the Prime Minister Decree on BOL both stipulate that it is BOL's explicit responsibility to raise the efficiency of the payment system of the financial sector. In the meantime, increasing payment system efficiency has been made a priority in the FIDS-2020.[273] [274] The existing interbank clearance system is rudimentary and has been mainly used for settling checks. Clearing is done manually and is timeconsuming. To facilitate and to secure payments made between customers of different banks, the banks hold reciprocal nostro and loro accounts, tying up large amounts of idle funds in the banking system and increasing the costs of the financial system as a whole. The future use of the new interbank clearing system has the potential to strongly increase the efficiency of the banking sector as a whole.

310. **IFC will support BOL to develop the payment system.** The new interbank clearing system itself, and the new products and distribution methodologies that can be leveraged on it require an adequate legal setting. IFC has agreed on a Memorandum of Understanding with BOL, to support BOL in the development of this regulation. As a step up, IFC will do a study into the payment flows in and to the Lao PDR; a study wich will give particular attention to the payment flows to and from the rural areas, and thus will have potentially interesting outcomes for RMF strategy development.

311. **Payment system and RMF providers.** Payments in Laos are mostly made in the form of cash and checks, and the percentage of the population with a bank

[273] Law on BOL, article 44, on (New) Payment Instruments: "The Bank of the Lao PDR shall establish payment mechanisms that assist commercial banks and financial institutions under its supervision to expand the use of payment instruments and to make payment by cheques and other instruments".

[274] Art. 3, sub 2 of the Law on BOL (05/NA, 14/10/1995) and art. 1, sub 2.2 of the PMO Decree on BOL (40/PM, 06/04/2000).

account is low. The two Lao banks with most outreach in terms of branches and service units, LDB and APB, still need to use a fax, phone and manually-based system to process payments within their own branch network.[275] However, the improvement of overall financial connectivity, the payment system in a broader definition, depends on the extent to which financial services providers are using a high quality, CORE-based banking system. The lack of such a system leads to inefficiency in processing financial transactions. Next to the already mentioned situation that banks hold large accounts between eachother in order to facilitate and secure payments, the process of manually handling financial transactions leads to loss of costly labour time and has a high likelihood of mistakes being made.

312. **Leveraging payment system for RMF delivery: Increase RMF outreach in terms of outlets and of services, reduce costs and extend product range.** The combination of the availability of CORE banking systems combined with the new, automated interbank clearing system in BOL opens up an array of possibilities with potentially significant impact for RMF service delivery. The combination allows for online, on time electronic processing of large amounts of financial transactions, limiting the possibility of errors and increasing transparency, while at the same time reducing costs and improving speed. Normal "account-to-account" money transfers, both within a bank and between banks, and both inside Laos and between foreign and Lao banks will be enabled, fast and at low cost. The large potential added value for RMF service delivery is in the extension of the distribution channel and the consequential capability to overcome the constraint posed by high transaction costs, due to lacking physical infrastrcuture, rough terrain and low population density. The leverage can be found in the linkup of a range of electronic devices and networks of agents to the existing financial sector infrastructure. The utilization of mobile banking combined with Point-of-Sale devices, of mobile-phone based financial transactions and of online banking will be in the realm of actual possibilities and in itself will lower transaction costs significantly if used by existing financial service providers. Increasing the leverage effect even more is possible by enabling the inclusion of networks of outlets and agents of telecommunication companies and private insurance providers. Inclusion of agents would allow for a network literally close to RMF customers. In particular the coverage of telecommunication services and mobile phones provides the opportunity to overcome the constraint of high transction costs, and could not only allow regular national and international money transfers but also enable extended outreach of other financial services for which the ability to make large numbers of low value payments are a neccesary condition, including various kinds of insurance, savings and loans.

313. **Summary and conclusions.** The development of the payment system in the broad definition is a priority for improved financial inclusion of low-income and rural households. With a technical system for interbank clearance and related regulation in the process of being developed, banks with outreach in terms of physical infrastructure (branches, service units) and a good-quality CORE banking system are increasingly wired to provide low cost, fast and reliable payment services. The next steps should be banks' and LPFI's marketing campaigns for RMF customers to open

[275] Both LDB and APB however, assisted by ADB, are in the process of rolling out a CORE banking systems over their branch networks, which should end the situation of using a manually-operated system to process payments.

payment and deposit accounts, with low requirements regarding initial amounts at opening and an allowance for the use of accounts in baht. The campaigns should focus on people migrating to urban areas in Laos and to those migrating to Thailand for work. For the latter, cooperation with Thai banks should be sought allowing for easy and inexpensive remittances through the SWIFT system. More structurally and long-term, options for leveraging on the existing framework by extending it with mobile banking, agent banking and mobile-phone banking should be assessed. BOL should be supported to organize thematic stakeholder forums and workshops with all relevant stakeholders to build trust, cooperation and ultimately a sector wide approach. BOL should be technically assisted by specialists to guide the process. Exposure visits to countries where the respective topics have worked out successfully could complement. The envisioned development can only happen if institutional capacity of organizations involved in providing the financial services, including which significantly banks, is at necessary level. This stresses the need for development of institutional capacity of institutions that lack it or for supporting the increase of the scale of services for institutions that are capable.

3.6 Apex institution

314. **There is no need for an APEX institution.** The main function of an APEX is to channel wholesale funds to MFIs that each MFI individually is too small to access, because of the difference in scale of operations between funders and MFIs (CMP 2010). The question "should there be an APEX institution" not only supposes a possible funding gap for MFIs, but it also assumes that what MFIs do with the funds, lending to RMF customers, is what is needed most in terms of demand for RMF services, that MFIs are best suited to do this and that there are enough retail MFIs with enough scale and institutional capacity committed to provide RMF services on a sustainable basis. Currently these conditions are not met, as also concluded after careful elaboration in a Concept Note on APEX institutions for Laos (CMP 2010). No major changes have occurred since the recent issuance of the Concept Note that would warrant a change in its main conclusions. The Concept Note was written by the consultant team of ADB's "Catalyzing Microfinance for the Poor Project" and finalized in 2009, then revised in 2010. It has been added to this assessment as Appendix no. 6.

315. **No need for APEX from demand side: APEX would be counterproductive for necessary savings mobilization.** As seen earlier, the main needs of low-income and rural households are means to deal with socio-economic risk and to smooth income and expenditures. In terms of products, improvement of delivery of various forms of saving products, financial connectivity, emergency loans, and health, social and agricultural insurance are main priorities. The need for a better operating market for monetary savings not only exists on the level of the individual households but also on the macro level. The fact that huge amounts of wealth are stored in unproductive, risky and illiquid form means that formal financial institutions are deprived of a secure and inexpensive funding base while the households miss a reward on stored wealth. Penetrating the market of depositors also brings sales opportunities for financial institutions in terms of "leads" for the provision of loans and other financial products, and builds a customer information base. Delivering APEX funds to MFIs will compete with MFIs' efforts to generate

savings and has the potential to create market dynamics that undermine the reward on savings for low-income households, and the processes of finding a core base of inexpensive funding and of including low-income households in the formal financial sector. An APEX institution also comes with the risks of flooding the RMF segment with (inexpensive) donor funding, and of undermining the focus on credit assessment, control mechanisms and repayment habits, ultimately adding risk to the financial system.

316. **No need for APEX from supply side: APEX would be counterproductive for necessary institutional capacity building.** Successful financial service delivery to low-income and rural households, including loans for productive purposes, hinges the on ability to reach large numbers of customers with demand-oriented products and delivery mechanisms by self-sufficient providers. The distribution channels that are needed can only be created by or within strong institutions with low costs per borrower or per transaction. Creating long-term, sustainable outreach requires institution building, new organizational and delivery structures with related internal control mechanisms, the use of opportunities offered by technology, development of demand-oriented products and the capacity of RMF providers to understand their customers in order to establish a long-lasting mutually beneficial relation. In Laos, strong institutions delivering good-quality RMF services with ample outreach are not yet enough available and building institutions and their capacity should have priority from a RMF development perspective. As analyzed earlier, in the current situation banks and semi-formal VSLFs are the main RMF providers and without significant changes will remain so. Efforts should focus on strengthening their institutional capacity and inclusion of the semi-formal delivery system in the formal sector, rather than on funding a small group of formal MFIs with little absorptive capacity.

317. **No need for APEX from supply side: the (theoretical) funding need is simply much too small.** In this paragraph we forego the previous analyses and focus on the funding need only. Looking at current regulations, licensed MFIs are only allowed to borrow externally up to amount equal to 30% of their outstanding loan portfolio externally which for all formal MFIs together would currently amount to $1.3 million. In terms of a need for additional funding, large VSLFs are known to have savings overhang just as some licensed MFIs and indeed some banks. There are current only three to four MFIs which come close to needing outside funding and have built basic capacity and structure within their organization. Still, there are ample opportunities to find funding outside the permanent structure of an APEX institution, including which importantly mobilization of savings, or direct funding by individual development organizations, the latter form often combined with additional benefits of the relationship between funder and MFI, such as TA and a network.

318. **No need for APEX from supply side: there is ample available commercial funding for strong institutions, with added benefit of market scrutiny.** For strong, transparent MFIs with a good track record there should also be funding sources available in the Lao banking sector. A still growing number of commercial banks have an amount of KN300 billion as a minimum requirement for their registered and paid up capital. For all existing banks the minimum amount has been raised up from KN100 billion which overall amounts to $500 million extra capital inflow, capital which has to make a return. With only a small market of larger companies and higher Nett Present Value individuals, there is logical pressure for

banks to downscale and commercial funding of well-functioning MFIs should be a normal market development. Commercial funding of MFIs has the added value of scrutiny by banks and consequential discipline. For VMLFs, there informality and lack of professionalism precludes APEX lending, while it has been observed that VMLFs perform worse, not better, when being supplied with outside funding.

319. **Comparison with the analysis and conclusion in ADB's Concept Note on APEX (CMP 2010)**. The analysis made and conclusions drawn in this assessment are highly similar to the ones made in the "Concept Note on APEX Microfinance Institution in the Lao PDR" mentioned earlier (CMP 2010).[276] Specifically the concept note concluded only in 2010 that: *"Unfortunately many apex microfinance institutions internationally have not performed to expected levels, with the majority having produced disappointing results. This is most often because they were set up in countries without a critical mass of good MFIs with the capacity to absorb such apex funding, which is indeed currently the case in the Lao PDR"* (CMP 2010, page 3). Indeed, it would have been ambitious to say the least to expect a large enough number of MFIs with good level of institutional capacity to develop over a time span of just two years. Sub-conclusions drawn in this assessment on the availability of commercial funding through banks for well functioning MFIs and on the primary need for building institutional capacity over funding were similar to conclusions drawn in the Concept Note. An analysis of demand for RMF services in terms of needed functions of the financial services or in terms of products has not been made in the Concept Note.

320. **Summary and conclusions.** ADB Microfinance Development Strategy (ADB 2000) has next to the requirement of "*the existence of an adequate number of retail level MFIs committed to provide services on a sustainable basis"* the condition of a *"demonstrated government willingness to provide a high level of autonomy to apex bodies"*. Based on these requirements and seen from the various angles described above there is no need for an APEX institution in the Lao PDR in the short or mid-term.

3.7 Training institutions and technical assistance[277]

321. **Shortage in qualitative and quantitative capacity.** Institutions able to deliver training and TA to build necessary capacity in RMF suppliers are in short supply, both in terms of their ability to train or technically assist large numbers of staff as in terms of the depth of their capacity.

322. **Urgent need because of growing formal financial sector.** Because of the strongly expanding formal financial sector, there is high demand for knowledgeable and experienced staff, the supply of which is static in the short-term because of the time needed to be educated and to learn from doing. Most of the financially strongest financial institutions, banks, use their financial power to "buy" staff by offering high

[276] See for a full reference the list of references in Appendix no. 1, under "CMP 2010" and for the full Concept Note Appendix no. 6.

[277] Sources used include Peege (2010) and "Development of an Undergraduate Course in Microfinance Management in Lao PDR." (October 20009), by S. Behrle for the German Cooperative and Raiffeisen Confederation

salaries, as they lack internal training capacity and structured human-resource development strategies. As a consequence, there is upward pressure on wages in the financial sector, while the quality of staff is diluted. Moreover, the stability of the human resource base inside institutions is undermined due frequent job-hopping of staff looking for higher salaries. Formal MFIs, more vulnerable because of their small human-resource base, are hit even harder as they can not offer the necessary leve of salaries. A more structural bottleneck, with potentially negative, long term consequences for the so needed institutional development within the financial sector is found in the lacking good quality facilities for TA and training. Most external RMF training and TA delivered is supply driven, paid for by donors and too expensive for RMF service providers. The exception to this situation situation is ABL, which has adequate in-house training and TA capacity.

3.7.1 ACLEDA ASEAN Regional Microfinance Centre

323. **AARMFC (ACLEDA).** Starting from Local Economic Development Agencies initiated in an NGO project in Cambodia which formed an Association which was named ACLEDA, eighteen years of development culminated in the creation of ACLEDA Bank Plc. (ABC), which successfully delivers high-quality financial services to hundreds of thousands of low-income and rural households in Cambodia. ABC has developed and institutionalized its own internal training and TA system. Part of the system is a rigorous policy for selecting staff based on transparent and value-related criteria combined with an internal training program to develop technical skills (Clark 2006). The internal training program as part of the Human Resource Development (HRD) strategy has culminated in the creation of the ACLEDA ASEAN Regional Microfinance Centre (AARMFC), which offers MF training both within as outside ABC. When ABC jointly with its long-term strategic partners started ABL, existing knowledge and methodologies were leveraged on, as ABL followed the same HRD strategy. All of ABL's current 400 Lao staff has received intensive internal training on all issues relevant to successful MF delivery and management, which included training in the AARMFC. AARMFC is able to train large numbers of staff from banks, formal MFIs and semi-formal VMLFs, yet currently has its own internal customers of ABC and ABL as its main focus. The AARMFC is assisted by German Development Bank KfW.

324. **Others.** Outside ACLEDA, specific MF oriented training and TA is only offered by a small number of providers employing but a handful of trainers overall, or two handfuls if specific assistance to VMLFs is considered. None of them deliver training to banks, pawn shops, or the LPFI.[278] Two institutions, the Microfinance Center and the Soutsaka School of Management & Technology, have received acknowledgement or (informal) accreditation from BOL to deliver MF specific training courses. Soutsaka however has withdrawn its MF training efforts, as it found their training could not be delivered on a commercially sustainable manner. No training institutions are known to provide training for the insurance sector.

[278] With the exception of a single training by TACDO on soft skills to all four state-owned banks earlier this year

3.7.2 Microfinance Center Laos

325. **MFC.** The Microfinance Center (MFC) is specialized in training and TA to formal MFIs and to VMLFs that are intended to formalize. It has two full-time training staff, and its owner and manager divides his time between running a licensed MFI called EMI, which is both sister-company and client of MFC, and running the training provider MFC. MFC provides training in all aspects of MFI management and is an accredited TA provider for the MIS system used by 75% of all formal MFIs in the Lao PDR called MicroBanker. MFC has a partnership with the Philippines based CARD MRI, a reputable group of mutually reinforcing RMF providers, technically and financially supported by the German Savings Bank Foundation for International Cooperation (SBFIC). MFC will also receive TA from CARD as part of the UNCDF supported MAFIPP program, which includes TA on micro insurance. Again paid for by the UNCDF-MAFIPP program, CARD and MFC will jointly train and technically assist a group of eight formal and semi-formal MF providers that have been identified by the directors of CARD and MFC. The basis for this TA is a tentative five-year contract between CARD and UNCDF, the performance of which will be evaluated on a quarterly basis. Simultaneously, CARD and MFC have a tentative plan to form a separate legal entity in the form of a joint venture through which in the future MF training would be offered. MFC and another training provider called EBIT (see immediately below in paragraph 326) are also main trainers of BOL's FISD.[279]

3.7.3 Economics Business and IT or EBIT

326. **EBIT.** The owner and manager of EBIT, who is a also a Certified Public Accountant, and one staff deliver MF specific training to formal MFI and VMLFs in bookkeeping, accounting, internal control, compliance and the use of MIS.

3.7.4 Training and Cooperative Development Organization

327. **TACDO.** A training company called TACDO is able to deliver training in general management skills through its owner and director. TACDO has delivered training to financial service providers, including state-owned banks and formal MFIs.

3.7.5 Microfinance long distance Training-of-Trainers course created by ADB, UNCDF and WB, through the Tokyo Institute of Learning.

328. Although not a training institution as such, a MF Training-of-Trainers course organized by ADB, WB, UNCDF and the Tokyo institute of learning has to be mentioned. In the recent past it has provided a low-cost long-distance learning course, the learning material of which has been translated into Lao language. The course was considered a good introduction in the main basics and principles of "Good Practice" MF and has reached dozens of Lao students.

[279] EBIT is an accounting acronym for Earnings Before Interest and Tax yet in this case refers to Economics, Business and IT.

3.7.6 Training and technical assistance to VSLFs and VRLFs

329. **Training and TA to VSLFs and VRLFs.** Training in setting up VMLFs and related bookkeeping practices is delivered by two specialized non-profit associations that have been registered as such at the Prime Minister Office. Together they employ some 10 to 15 staff and sometimes involve volunteers.[280] In some projects that have set up VSLFs or VRLFs, NSOs have been set up which have been mentioned in the paragraphs on semi-formal RMF supplies.

3.7.7 Banking Institute or Bank Training Institute

330. **BTI.** The so-called Bank Training Institute (BTI) or Banking Institute is a part of BOL and was initially created to (further) educate existing staff of state-owned banks. Over the last four years, the BTI has expanded to become a training institute for the banking sector from which some 600 people graduate per year. The number of students has been growing strongly, from a total of 250 students in 2002 to 2.200 sudents in 2009, as a result of the decision to open the BTI to full-time students that enter the BTI following completion of secondary school. In 2009 those secondary-school graduates made up 60% of the total number of students. Since 2008, in an effort to build the human resource capacity needed for a growing financial sector, the BTI has been supported by the international development organization Lux Development. Lux Development technically assists the development of the general curriculum and the upgrading of facilities, such as buildings and library. As part of the development of the curriculum, the BTI intends to design a program that will built students to the level of a bachelors degree. Traditionally the BTI had no curriculum in MF. The recently started UNCDF supported MAFIPP program however has budgeted a significant amount of $1.2 million that will be used specifically to develop a MF curriculum and MF learning materials, and to train two newly hired BTI staff to become MF teachers. The teachers have no prior specific MF knowledge or experience and have to start from scratch.

3.7.8 National University of Laos

331. **NUOL.** Related to MF training at university level, the National University of Laos (NUOL) has both a Masters program in Development Economics and a Bachelors level degree of which Development Economics is a main part. Rural finance is being taught as part of Development Economics at both levels. Both curriculums are fixed and would take time to go through the necessary procedures for approval if proposals would be made to include RMF as a subject. Masters level students, some 40, are almost without exception further up in their career and study to be able to make promotion within their career. Bachelor students, of which there are hundreds, are young and many of them do not yet have a specific career objective. The curriculum of both levels consists mainly of theoretical issues and lacks a connection to the practical needs of everyday RMF service delivery, but for one relevant exception. Almost all students on both levels that write a paper or do some small survey related to MF choose to research the subject of "Consequences for

[280] The Lao Community and Sustainable Development Promotion Association (LCSDPA) and the Non profit Association for Lao Development and Environment (NALDE)

socio-economic wellbeing of clients of VSLFs". Many use the structure of similar theses written earlier on this subject and apply them to other villages. Recently, various Lao national media have reported statements made by senior government officials on the government education system, mentioning problems with interference, payments made by (parents of) students to teachers in order to graduate students or allowing them to enter a course, demands made by teachers and similar issues.[281]

3.7.9 Private colleges

332. There are a number of good-quality private colleges which graduates are working as banking sector staff. The already mentioned Soutsaka School of Management and Technology not only has a BOL accreditation as microfinance training centre but has the intention of building a school for the banking and finance sector. Other known schools include Lao-American college and Rattana Business Administration college. The private colleges are flexible, work with a hands-on private-sector orientation and have a focus on finance related issues. They deliver significant numbers of graduates to the labor market and would be well placed to reach large numbers of students with a practical, RMF related curriculum.

333. **Summary and conclusions.** There is a lack of training and TA facilities for the financial sector overall and for RMF service providers in particular, with the exception of ABL. With the financial sector regulatory framework increasingly in place, allowing for the creation and expansion of both banks and various types of NBFIs, there is an increase in the number of financial service providers and in the outreach and complexity of their service delivery. These financial service providers need not only in-depth knowledge on how to build the institutional systems that make a strong financial service provider, but also specific knowledge on RMF service delivery and the means to transfer the knowledge systematically to a large number of inexperienced, newly recruited staff. Since the expansion of the financial sector is already taking place, the related need for TA and training is urgent. To deal with this immediate need for TA and training at the required level and scale, strategic partnerships should be formed with foreign partners that have proven success in RMF delivery in a similar setting and are capable of transferring necessary knowledge and systems to their partner, a Lao RMF provider, and combined with a financial stake. On the longer term, institutionalizing the transfer of knowledge and experience to make it available to a broader audience remains an issue to be dealt with. However, because of the time lag involved in institutionalization, a study of available options and their feasibility aspects as a first step to designing a strategy for higher financial education should be considered. As part of the analysis it is advised to consider engaging in the design of a curriculum and of teaching material, and of a delivery system of experienced financial sector professionals as teachers, and to seek partnerships with existing well-organized platforms of higher education. In the Lao PDR schools of higher education that deliver large numbers of graduates and have their infrastructure largely laid out are available. They include both private colleges, such as Lao-American College, Rattana Business Administration College, Com Center, and Pakpassack Technical College, and government institutions, such as

[281] Source: Vientiane Times 7 July 2011 and 8 April 2010, press release Ministery of Education 28 August 2008, interviews.

NUOL, BTI and the Economics and Finance Institute of the MOF. The ultimate objective should be to transfered the expertise to a critical mass of local professionals.

3.8 Coordination and advocacy

334. **Lack of coordination is main constraint.** Lack of coordination has repeatedly been identified as a main constraint for successful RMF development and seems logically linked to the assessment that a critical mass of key decision makers with ample understanding of building sustainable RMF systems needs to be build. Since the number of decision makers influencing RMF and its development is larger than the group with a thorough understanding, exchange of information, of knowledge and of solutions, interaction with RMF professionals and ultimately the design of a coherent vision on RMF development carried by a broad group of decision makers are key needs.

335. **Coordination between which organizations?** The need for coordination exists between and within government organizations, between and within development organizations, as well as between the government, development organizations and practitioners. A complicating factor is the fact that policy and decision making processess are centralized, lack transparency and have a focus on procedures. Often formal consultations with an extensive number of non-sector specific government stakeholders are involved.

3.8.1 Existing coordination structures and mechanisms

336. **Coordination at policy level: Round Table Meetings.** Various structures exist through which coordination and advocacy have been institutionalized. Official Round Table Meetings divided in sector working groups have been organized to put the Paris and Vientiane Declaration in practice and form the main platform of coordination between the government and development organizations. The financial sector, despite its significance for overall socio-economic development, does not yet have a separate sector working group. As the Round Table Meetings take place at the level of the central government and give direct input to the most important policy document, the NSEDP, it is a crucially important coordination mechanism for any form of development effort, including RMF development.

337. **Public-Private Dialogue.** Direct communication between the private sector and government takes place in the Lao Business Forum, organized by the Lao National Chamber of Commerce and Industry. Those constraints blocking the well functioning of markets and the private sector can be addressed beyond the level of normal direct communication with a concerned government agency. There is a financial sector working group which includes all banks, insurance companies and non-bank financial institutions. As the whole group has to approve issues to be brought forward, sometimes issues that affect many end-clients but few companies will not make the cut. This is particularly true for issued related to low-income and rural households, to which few larger private companies deliver services yet constitute the largest market in terms of number of customers.

338. **Informal sector organizations: Lao Bankers Association and Microfinance Working Group.** Banks and non-bank microfinance suppliers both have informal sector working groups.

339. **Lao Bankers Association.** The Lao Bankers Association only since recently has all banks involved and does not yet have a specific mission or agenda. It has traditionally been presided over by a Managing Director of a SOCB. With a rotating chair and a large number of new privately owned banks as members the dynamics might well change and the Lao Bankers Association might become a real sector interest organization. It recently established a secretariat and is member of the ASEAN bankers association.

340. **Microfinance Working Group (MFWG)**. The MFWG is an informal organization mainly involving smaller development organizations working specifically on microfinance through formal MFIs or VMLFs and a handfull of the strongest and largest formal MFIs. The MFWG is rather supply driven. Banks, VSLFs and other NBFIs involved in RMF delivery are not much involved and sector oversight from a demand perspective is lacking. The MFWG has however managed to organize funding, TA, an office and a place for itself as a MF stakeholder, and tries to turn the challenging concepts of ownership, coordination and advocacy into reality. The MFWG was initiated in 2007 and in particular over the last year has made ample progress in improving its organization.

341. **Summary and conclusions.** Communication and coordination is much needed, as RMF development issues and their solutions depend on the understanding and cooperation of a broad group of various stakeholders. Coordination and communication processes through which information is shared and issues are solved are both politically and culturally determined. Culturally embedded communication combined with working along existing governance structures and informal norms yields best outcomes and could benefit from intermediation by Lao nationals qualified at communicating at higher political level. The time for constructive dialogue seems right, as recently four breakthrough steps have been adopted by the LPRP and the government as leading principles for socio-economic development for the period from 2011-2015, and form a solid basis for the 7th NSEDP.[282] Crucial issues regarding RMF development should be brought forward through the platform of the Round Table Meetings in order for the key principles related to RMF development to be heard, understood, accepted and supported at the right political level by a critical mass of key policy makers and be embedded in the leading policy document on socio-economic development which is the NSEDP. ADB is advised to suggest the creation of a separate working group for the financial sector as part of the Round Table Meetings. This would give financial sector issues, including RMF development issues, the needed attention from a technical perspective and would be in line with the financial sector's relevance for overall socio-economic development. Thirdly, communication and coordination could be supported by ADB by organizing

[282] Source: H.E. Mr Somsavath Lengsavad, member of the LPRP's Political Bureau, Standing Deputy Prime Minister and President of the Board of Directors of the Bank of Lao PDR speaking at LPRP's 9th National Congress in Vientiane, April 2011. Four breakthrough steps: 1. to relieve the minds of people from old stereotypes, complacency and extremism; 2. develop human resources; 3. address administrative procedures and management which impede commercial productivity rates and services; 4. address poverty.

thematic workshops, perhaps organized jointly with BOL, centered on main RMF development issues. The workshops should include all stakeholders relevant to solving a particular RMF development issue at hand, should be interactive and should be actively and professionaly moderated. Each of the workshops should deal with a single thematic RMF related issue of the intention should to be to solve it during the workshop or at least define a set of concrete follow-up activities that constitute the critical path towards solving the issue.

D. Key Constraints and Development Needs

1. Coherent vision

342. **There is a key need for a coherent and holistic vision on how to build demand-oriented RMF delivery systems, that are both sustainable and inclusive for lower-income and rural households.** The existing RMF Policy Statement embeds this vision yet various alternative visions on RMF development and definitions of RMF exist both in policy documents and in practice, and are broadly accepted. For the vision found in the RMF Policy Statement to be realized, ownership of and support by critical mass of key policy and decisions makers is crucial, and should be followed-up by embedding it in main socio-economic policy and strategy documents, specifically in the 7th NSEDP and the FIDS-2020.

2. Information and transparency

343. **There is a key need for more publicly available, reliable and good quality information on both RMF demand and supply.** More information is needed on socio-economic characteristics of low-income and rural households, and their specific needs in terms of financial services; on individual RMF providers; on the overall financial system; on experience and results of various RMF initiatives; and on the government's policies and strategies for the development of the RMF service delivery. Ways to meet this need include publication and ample dissemination of information that is already available, enforcing existing regulatory obligations to produce financial information, designing and institutionalizing data collection, and improving the reporting and accounting standards for financial institutions and micro enterprises. First and foremost, there is the need for acknowledgement of the importance of transparency for the trust in the financial system and of the availability of ample, good quality information for good quality policy and decision making.

3. Improve communication and coordination

344. **There is a key need for increased open communication and coordination between RMF stakeholders, led by the financial sector authorities.** The extent to which RMF service delivery is achieving its objectives depends on a constellation of mutually interrelated and dependent actors at macro, meso and micro level. Ultimately the services are delivered by retail-level actors for which conditions should be created enabling them to do their job well. As their enabling setting is mainly determined by the financial sector authority, which is at the centre of the responsibility to build a sound financial system inclusive for low-income and rural households, for the latter, the Bank of Lao PDR, it is highly advisable to initiate regular, open and constructive communication, and to both lead and stimulate coordination of efforts by stakeholders at all levels.

4. Enable and support household-based micro enterprises

345. **There is a key need to develop and implement policies and strategies specifically aimed at enabling the growth and emancipation of household-based, micro enterprises.** In Laos, over 90% of enterprises are informal, household-based micro enterprises. They employ the large majority of the overall workforce and their combined added value is estimated to over a third of GDP. Still, no specific strategy exists to support them as the current SME Development strategy does not encompass "microscopic" enterprises. For micro enterprises informality is a profit-maximizing choice as formality comes with a burden of mostly admin and tax-related issues. In effect these issues constitute a constraint for the growth of the micro enterprises themselves and for the overall Lao economy, both of which forego the benefits of economies of scale and of scope. Next to informality, also the household-based organizational structure of the micro enterprises brings specific features which warrant specific measures to allow for their success. Good quality RMF service delivery has the potential to enable and stimulate micro enterprise production, yet the overall success of micro enterprises, and in effect the overall positive impact of RMF, depends on factors beyond RMF alone.

5. Strengthen rural and microfinance supervision

346. **There is a key need for strengthening RMF sector supervision.** As a consequence of the improved enabling environment, of the low starting levels of financial intermediation and of the strategy to support economic growth by increasing the provision of credit, the financial sector overall has grown rapidly. Existing providers have expanded activities and the number of providers, mainly privately owned, has doubled over the last five years. This growth, in the light of the weak institutional capacity of many of the RMF providers, significantly including weak internal control and risk management capacity, poses potential risks to the soundness of the overall financial system and to individual providers. Additional roles and responsibilities have been assigned to supervisory departments while their supervisory capacity was low to begin with. Moreover, over half of the total number of staff has only recently joined and consists of freshly graduated youngsters.

6. Enable the role of commercial banks

347. **Commercial banks have the potential to play a major role in RMF-service delivery in Laos and should be encouraged or at least allowed to do so.** In the current situation there are various ways in which banks' involvement in RMF delivery is discouraged. An overall instruction forbids banks to have a spread of over 5% between the interest rates on deposits and on loans, and in effect does not allow for economically rational financial service delivery to the RMF segment, limits outreach and discourages the development of the specific products and distribution methodologies that are needed by low-income and rural households. State-owned financial service providers have little discretion to independently develop and implement a strategy aimed at becoming a sustainable RMF provider. Product development and interest rate setting both depend on BOL's approval or instruction, which has reported to be determined by considerations beyond prudential supervision and to limit the possibility for sustainable RMF delivery. The designation of one particular target group to an individual State-owned financial service provider

disallows for risk diversification, and makes for inefficient use of the physical infrastructure and human capital. Private Banks have been verbally instructed not to deliver micro loans.

7. Integration of semi-formal, village-managed RMF providers

348. **There is a key need to integrate VSLFs and related NSOs into the formal financial sector, based on mutual understanding, trust, cooperation, support and reinforcement.** A main existing model for RMF provision in terms of demand orientation and outreach is that of the VSLFs. The semi-formal model of the VSLFs has built support structures, has been based on semi-formal regulations and has the back-up of powerful political organizations with networks reaching out to each and every Lao village. The VSLF model has been based on the original design of credit cooperatives which has been adapted to the Lao cultural and political setting; its success can largely be explained by this adaptation. Currently, VSLFs and their model forego the benefits of being a part of, or being linked to, the formal financial sector. Their success makes for increasing responsibility over a growing amount of funds for most of the VSLF management teams, while lacking technical capacity and lacking access to professional TA limits their institutional capacity. The current formal microfinance regulations have been designed and issued without the benefit of including the existing successful practice of the VSLFs and their NSOs.

8. Institutional capacity

349. **There is a key need to enhance the institutional capacity of (main) RMF service providers.** Most of the existing main RMF providers (APB, VSLFs, the LPFI) existing smaller providers (DT MFIs, SCUs, PSB, SSO) and potential providers (LDB, Lao Telecom) need strengthening of the institutional capacity. In Laos, there is a lack of organizations that can deliver the needed TA. The exception if found in ABL.

9. Financial connectivity

350. **There is a key need for increased financial connectivity.** The possibility to make small payments or withdrawals, at low- transaction costs and in a nearby outlet that is connected to the formal financial sector, would allow for a range of benefits for low-income and rural households. First of all it would enable transferring and receiving money both within Laos and from abroad, for which there is huge demand due to large scale labor migration to urban areas and to Thailand. Significantly, it would also enable saving, repaying principal, paying interest and paying premiums for health or private insurance, and thus allow for the expansion of delivery of a broad range of financial services for which there is large demand by low-income and rural households.

10. Consumer protection and financial literacy

351. **There is a key need for improved consumer protection and support of financial education.** Laos' society is in a process of transformation from a subsistence level, lowly monetized economy to a more market-oriented economy. As part of that process, financial services are playing an increasingly important role, just

as planning economic activities and making related calculations. As has been observed both in Laos and internationally, even in an already monetized society a strain is put on the skills of the financial managers of low-income households to deal with uncertain and fluctuating income and expenditures, as often the general level of education is low. With financial services playing an increasing role in Lao society, an increasing number of households depend on the reliability of the financial system for their socio-economic wellbeing. As currently protection of consumers is not at adequate level, while simultaneously institutional capacity of financial service providers, financial sector supervision and transparency all need strengthening, there is a need to regulate and institutionalize the protection of consumers of financial services.

11. Sequence and focus on strategic objectives

352. **Key Need: Sequencing, thematic multi-stakeholder approach, focus and identification critical path.** There is a range of other key development needs, such as for example studies into the feasibility aspects of the provision of agricultural insurance and warehouse-receipt financing, into the lack of demand for private insurance and into the feasibility aspects of involving agents and telecommunication companies in financial service delivery, the need to improve the depositor protection system. With such a broad range of issues and because of their interrelation, the issues of sequencing and of defining the critical path come into play. Regarding sequencing, as an example, the best way to insure deposits is to only lend to good customers by making good loan assessments, having good internal control and risk management measures within RMF providers combined with strong RMF supervision. Strengthening the formal depositor protection system should build on strong institutional capacity of retail providers and strong supervision. Next to sequencing, focus on achieving a particular strategic objective of RMF development requires the inclusion of all stakeholders relevant to realizing the objective in the process and the identification of all activities that are part of the critical path. For example, in order to increase financial connectivity through developing mobile-phone based payments led by banks, there should be banks with a well functioning CORE banking system and a network of service units; a Central Bank that provides adequate supervisory activities and consumer protection; a telecommunication provider which has enough expected added revenue and the financial strength, willingness and strategic objective that would warrant the investment in the necessary technical systems worth while; and customers that are aware and open to use mobile phones to make payments. Focus should be on the main strategic objectives, which should be approached by appropriate sequencing, identification of the critical path and a process which involves all stakeholders critical to the achievement of the specific objective.

III. STRATEGY UPDATE

A. Government Policy, Strategy and Plans

353. **7th NSEDP (2011-2015).**[283] As mentioned earlier, the NSEDP is the leading policy document on socio-economic development and contains the strategic priorities for the coming five-year period, decided upon at the highest political level. Although the 7th NSEDP is currently in the process of being constructed, some details of strategic priorities related to RMF development have been made known.

Analyzing the recently concluded five-year period the expansion of VSLFs and VRLFs, and the expansion of the social-insurance system are considered main achievements. For the future the 7th NSEDP wants the expansion of micro credit and adequate loans to SMEs. In order to achieve this, effort will be made to improve banking regulations and supervision of financial institutions. Elsewhere in the 7th NSEDP a broader scope is used where it states it is needed to *"Develop means to make institutional finance accessible to those who have not availed"*. As institutional finance is broader than mere micro credit some additional clarification is needed, as analyzed earlier. Some further targets that have been given include:

- Savings mobilization has to go up,
- SMEs, small and household businesses should be promoted,
- Social insurance should be strengthened,
- Health insurance should cover 50% of the population in 2015.

A separate, general directive in the NSEDP stresses the importance of the Rule of Law and training of government officials in areas such as governance, expertise, ethics and morals.

354. **Financial Institution Development Strategy until 2020 (FIDS-2020).** On the proposal of BOL, which for this purpose had been supported by the World Bank, the Prime Minister has issued a Decree in 2010 which intends to become *"the guidance and reference for the development of financial institutions in the Lao PDR in a systematic and integrated way, leading to a strengthened, stabilized and modern economy"*. [284] [285] The document is called the "Financial Institution Development Strategy of Lao PDR from 2009-2020" and has a few new and important features that could be considered improvements. It aims to guide for a long period, is explicit, transparent and concrete, and it mentions a number of relevant financial sector constraints to be dealt with. The FIDS-2020 explicitly states that details mentioned in the document have been *"analyzed, consulted and shared directly with all concerned agencies (many times)"*. FIDS-2020 does not have a specific section on RMF, but RMF is mentioned as part of the overall financial sector.

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[283] This paragraph repeats parts of the content of paragraph 184 on page 63, in order to give a complete overview in this chapter on the government's policies and strategies.
[284] 273/BOL, 22/09/2009
[285] Governor BOL, 13 November 2011

355. **Further clarification would be beneficial.** The FIDS-2020 could be further improved with additional clarification, an outline of concrete actions, prioritization and sequencing. The FIDS-2020 has already anticipated the need for adaptation and stipulates there will be reviews and evaluations, and that the measures and methods have not been fixed, as any good strategy document would do.

356. **Clarification: FIDS-2020 and its relation to the NSEDPs and RMF Policy Statement.** Main and central question is how the FIDS-2020 relates to the priorities and strategic directions mentioned in the (6th and) 7th NSEDP and how it relates to the RMF Policy Statement. This question is significant as the various policy and strategic documents could do with improved coherency on some central issues related to RMF sector development.[286]

357. **Clarification: FIDS-2020 and its relation to insurance.** A second issue is whether or not the FIDS-2020 relates to insurance providers, both private and social insurance. This, because the FIDS-2020 has received the legal status of a PMO Decree and mentions insurance yet has been drafted by BOL, while other ministries are responsible for the supervision over the various insurance sectors.

358. **FIDS-2020 and RMF related priorities.** We highlight priorities with relevance for RMF service delivery:

i. **Improved data reporting and management for the banking sector.** The data will serve to support development of analyses based on a more detailed, timely and broad set of data on both banks and their customers, which as we have analyzed above is indeed a main development need.
ii. **Development of indirect monetary instruments combined with phasing out of direct involvement in banks operations.** If this is implemented it will allow APB, LDB and all banks to develop products and delivery mechanisms that are more tuned to meet demand, and set prices according to costs and risks incurred as intended by the introduction of NEM in 1986.
iii. **Strengthening supervision of both banks and non-bank financial institutions.** Since over the last five years the total outstanding loan portfolio and the number of financial service providers have grown so strongly while issues central to responsible financial management such as credit assessment, internal control, risk management, accounting standards and supervisory capacity have been observed to be weak, strengthening of supervision indeed should have high priority, as the current situation constitutes a risk to the overall soundness of financial sector. Priorities mentioned include the obligation for banks to upgrade their accounting and reporting standards to IFRS and the second of the Basel Accords issued by the Basel Committee on Banking Supervision, and further include the importance of publication of financial information on performance and of fair competition.
iv. **Develop and strengthen internal administration and governance.** The intended improvements in governance and changes in definitions of roles are aimed at BOL, banks and non-bank financial institutions, and significantly, at semi-formal providers.

[286] The issues hinted at are discussed earlier in the paragraphs on policy documents, regulations and supervision.

359. **FIDS-2020 and the Financial Institution Infrastructure.** Financial sector infrastructure is used here having the broad meaning of the overall setting for financial institutions. The FIDS-2020 mentions what should be done to improve this setting:

360. **Legal framework.** The legal framework for the financial sector needs to be created and disseminated by the responsible authorities; its implementation should be monitored and in case of weaknesses urgently amended. On longer-term the framework should be upgraded to international standards. [287]

361. **Upgrading accounting system.** The accounting system should be upgraded by BOL to IAS, aligned with BOL guidelines and uniformly applied through all (types of) financial institutions. BOL will coordinate with concerned authorities on the issues of dissemination and implementation.

362. **Development payment system.** Next to facilitation of the creation of the payment system, both in technical and legal terms, the new system should be implemented nationwide and be improved, after which its legal stature can be upgraded.

363. **Depositor Protection Fund.** Regarding the development of the DPF many strategic tasks have been mentioned; regulations be upgraded and for the future be at international standard, an early warning system for risks inside institutions and for external risks has to be designed, membership should be expanded, new depositor protection products have to be developed, efficiency has to be improved depositor protection has to based on risk assessment in order to determine adequate level of premiums.

364. **Human Resource Development plan.** HRD is mentioned as a priority because as FISD-2020 states, human resources determine the success of overall financial sector development. For the future, SOCB staff should be selected and evaluated based on professional and moral merit, and should be rewarded accordingly. Training and education are considered necessary to meet the professional requirements of the financial sector's development. In order to meet this necessity the Banking Institution has to be developed and the overall human resource development training has to be aligned with the Lao PDR's overall development goals.

[287] BOL for banks and non-bank, non-insurance financial institutions; MOF for private insurance; MLSW for social insurance and MOH for health insurance

B. ADB's Sector Support Program and Experience

365. **ADB's involvement.** ADB has provided intense support to the restructuring of the Lao PDR's financial sector for a period of more than two decades. In the Country Strategy and Program for 2007-2011 for Laos (CSP 2006) issued in 2006, lessons learned until then have been summarized. Furthermore, the CSP outlined support based on an assessment of the government's priorities for financial sector development as found in the 6th NSEDP.

366. **Main lessons learned: political backup of reform efforts is of critical importance, weak governance is key constraint.** The main lesson learned at that time was that it is extremely important to asses the government's commitment and capacity to undertake the reforms that were intended or agreed upon, as well as the political and economical factors that shape incentives (CSP 2006). The CSP analyzed that as a consequence of political inertia and insufficient technical capacity significant delays had occurred. Among the key constraints that had been identified were weak governance in particular in BOL, which *"continues to act as the actual manager of SOCBs"*, limited technical capacity and a lack of financial infrastructure (CSP 2006). Another main lesson learned according to the CSP (2006) is that effective implementation could benefit from close monitoring and long-term TA from international consultants. Specifically regarding RMF, the assessment made in the CSP (2006) was that APB's subsidized operations distort the rural finance system and crowd out sustainable RMF provision, while the lack of a transparent regulatory framework and administrative interference deter investment in sustainable RMF provision.

367. **Despite lessons learned: lack of alignment with NSEDP as main policy document.** In order to deal with the constraints, ADB supported financial sector development in a set of various programs combined in two clusters; the BSRP and the RFSDP. The CSP (2006) analyzed that both programs reflected the reform program for the financial sector embedded in the 6th NSEDP (2006-2010). As read earlier in this assessment, our view differs, as we found the NSEDP regarding financial sector development inconsistent, not clear about priorities and at odds with main principles of the Policy Statement for the sustainable development of the RMF sector. For example, the 6th NSEDP (2006-2010) promoted subsidized and low-interests loans to be delivered through APB and VRLFs in order to reduce poverty, in order to support SME development, and in order to support emancipation of the genders and the disabled. The 6th NSEDP (2006-2010) was also less than clear about the reduction of BOL interference in SOCBs and actually gave indications of the idea of continued interference. Both BSRP but in particular the RFSDP however built on the principles found in the RMF Policy Statement.

368. **Steering and monitoring methodology: Governance Agreements.** In order to steer implementation of the BSRP and RFSDP based on mutual commitment to achieving specific objectives, Governance Agreements (GA) were drawn up and signed by BOL, MOF, and both the board of directors and management of the SOCBs. The implementation of the GAs was technically assisted over a long time span by international consultants and closely monitored in professional external audits. Implementation was also monitored by ADB itself, in as far as formal

issuance of policy, strategic and legal documents by the government had been agreed upon as part of the support program.

369. **Banking Sector Reform Program (BSRP).** The BSRP provided direct support to the SOCBs and intended to improve the broader enabling environment for banks. The evaluation of its effectiveness showed mixed results. Targets that were set to indicate improved performance as a result of the process of restructuring and recapitalizing the SOCBs have largely been achieved. In this success the GA's have played a key role (BSRP 2010).

370. **Lessons learned BSRP.** The evaluation reports of the BSRP explain that political support is vital for success and give the recommendation that for the future ways should be sought to increase BOL's autonomy and separate it from the executive part of the government. The reports also recommend that BOL should focus on its role as supervisor and that BOL's supervisory capacity should be strengthened. Secondly, the BSRP evaluation reports recommend that support to SOCBs should focus on strengthening credit assessment based on cash flow analysis, and on strengthening related internal control procedures and capacity. Thirdly, the reports recommend ADB to focus, and when designing a program of assistance not to spread out over too many subjects or over too many different government agencies.

371. **Lessons learned Rural Finance Sector Development Program (RFSDP).** As part of the RFSDP a policy and regulatory setting for formal MFIs has been created; a special division in BOL has been set up to supervise and monitor formal MFIs; and the State-owned policy bank APB has been organizationally and financially restructured for the specific objective to turn it around to become a market-oriented, financially self-sufficient rural finance bank.

372. **Policy Statement formed the basis for the RFSDP but was lost in the NSEDP (2006-2010) and FIDS-2020**. The foundation for the RFSDP was laid in the form of the RMF Policy Statement, which had been issued at the RFSDP's start by an ad-hoc government committee installed for the specific purpose of creating the RMF Policy Statement. An action plan was attached to the RMF Policy Statement which has been updated in 2008. In the latest ADB progress report on the release of the tranche of RFSDP program loan (RFSDP May 2010) the conclusion drawn based on the evaluation of the RMF Policy setting was the current RMF Policy setting is clearer. Our analysis in this report is that from a perspective of building inclusive RMF financial systems, the RMF Policy Statement is adequate and should be implemented. However, its key principles were contradicted in the 6th NSEDP (2006-2010) and do not specifically feature in the FIDS-2020, leaving ample room for further improvement of the RMF Policy setting.

373. **Microfinance Institution Division ≠ Microfinance Division.** The "Microfinance division" that has been mentioned in documents related to the RFSDP and has been created in BOL has in fact never been a "microfinance" division. Rather, a "Microfinance **institution** division" had been created. The distinct and important difference is found in the fact that only providers licensed by the MFId are dealt with by the MFId. All other (types of) providers of RMF services, amongst which the largest providers in terms of outreach (banks and semi-formal providers) and also insurance providers are out of its scope (also: RFSDP 2009). Significantly,

the MFId had been made responsible for a range of NBFIs other than formal MFIs, some of which indeed also provide RMF services but some of which that don't. As a consequence, international development organizations that intended to support sustainable (R)MF systems development had mistaken expectations as to the MFId's mandate and responsibilities, and were prone to miss out on a clear and overall picture of the RMF playing field.

374. **Pressure interference APB policy lending to be expected.** Regarding the RFSDP's measures to strengthen the SOCBs and in particular APB generally the outcomes as agreed in the GA have been achieved satisfactorily. A RFSDP evaluation report does however mention *"regulatory forbearance on the part of BOL"* (RFSDP 2009). The report further analyzed that there pressure could be expected for APB to restart policy lending or otherwise to be subjected to interference in its operations after expiration of the GA and release of the final tranche of the program loan (RFSDP 2009). Finally, the report states that there is a clear intention by the government to restart policy lending and that this could undermine progress made in developing a more sustainable sector. The report finds indications in the fact that NBB over time has strongly expanded its activities. The observations made in the report are, as we have seen, in line with the main RMF policy direction found in the 6th NSEDP (2006-2010).

375. **Lending by APB increased (too) fast, monitoring and controlling risk is critical.** At the time of the issuance of the RFSDP evaluation report, lending by APB had by far exceeded targets, with potential negative consequences for portfolio quality and financial strength (RFSDP 2009). The instruction to extent lending in the pace that is has, had been given by BOL with the objective to fuel nominal economic growth. The RFSDP evaluation report advises that the ability for APB to operate on a market-oriented basis is fragile and that constant attention to achieving key performance indicators remains necessary (RFSDP 2009).

376. **Ownership and clarification of objectives in (governance) agreements are a necessary condition for success, just as setting targets realistically and monitoring strictly.** Regarding the use of GA's when working on financial sector restructuring, a lesson learned during the RFSDP has been that it is highly important both to draft the GA together with the GA's implementers and find the necessary ownership, and to explain the (relevance) of the GA's content to a core group of decision makers. Importantly, RFSDP evaluation reports further advise that what the targets that have been agreed upon should realistically be able to be achieved, and stresses the importance of complete realization of targets and of strict monitoring.

C. Other Donors' Support and Coordination

377. **Coordination between ADB and BOL, and with other donors.** Microfinance has received a lot of worldwide attention and support, in particular over the last five years since the Nobel Prize was awarded to Muhammad Yunus and Grameen Bank for their efforts to create economic and social development from below. Laos was no exception and as a consequence both the MFId and formal MFIs have been offered overwhelming financial and technical support by many donors. The MFId and formal MFIs have been particularly targeted as counterpart by development organizations working on RMF development since their names include the word "microfinance" which suggests they are the right counterparts. As a consequence, abundant support has been funneled to a small group of formal MFIs with little outreach and to the small MFId responsible for supervising them, both with few staff and little absorptive capacity. In cases, various programs offering support to RMF development had overlapping activities, leading to the situation that the same (type of) support was given by different programs. Similar support has been offered simultaneously and in some incidences one program's support replaced systems installed by other donors without ample needs assessment. Because of the time lag between the moment a demand for assistance is made and the start of implementation of a program, in the meantime the need for that particular assistance might not longer exist because of involvement of other donors. The overall situation described constitutes a need for flexibility in the design and implementation of RMF development assistance, and a need for continuous coordination with other development organizations and with the government counterpart.

378. **Coordination donors working on VMLFs.** Outside the formal sector, RMF development also needs intense coordination. A group of different development organizations and government counterparts support VSLFs and face the same challenges. Often, they try to design a strategy that allows for sustainability of the (groups of) VMLFs and do so in isolation, with little exchange of experiences both between the development organizations and with the financial sector authorities. In the search for new, innovative ways to strengthen the institutional structure of (groups of) VSLFs, most sought for ways are the creation of NSOs formalization of VSLFs (and VRLFs for that matter) within the current regulatory setting.

379. **Support.** Below follows a structured overview of existing donor support at various levels of intervention, macro, meso and micro (retail).

380. **Macro level support: Policy, strategy, regulation, supervision**

Organization	Support	Donor
BOL FISD	Adapting regulations for formal microfinance providers and upgrading the legal stature to become a Prime Minister Decree	GIZ-AFP
BOL FISD	Supervision and inspection of formal microfinance institutions	GIZ-AFP
BOL FISD	Training and exposure visits for FISD management and staff on "Good Practice"; policy studies and stakeholder meetings on sustainable MF solutions for Laos; English training of FISD staff	UNCDF-MAFIPP
BOL	Developing regulations and/or a legal setting for the payment system. Duration, funding and specific topics are not yet known. IFC indicated the MOU was intended to be all encompassing, including the regulation of all payment system related issues.	IFC and EU
BOL CIB (BSD)	Developing regulations for the responsibilities, procedures and workings of the CIB and its members / customers. The regulations allows for both banks and non-bank financial institutions	IFC
MOJ	Development of regulations for registries of secured transactions, motor vehicles and land	IFC
MOH	Community Based Health Insurance	Lux Development
MOH	Pilot Health Equity Fund	WB (5 distr.); Lux Dev. (9 distr.)
MLSW Social Security Department	Strengthening social-security organizations and supporting health financing and strategy reforms	ILO and Lux Development

381. **Meso level support: Financial sector infrastructure**

BOL CIB (BSD)	Support development (hardware, software, training, awareness raising, capacity building), currently only for banking sector.	IFC and EU
MOJ	Support development of technical infrastructure (hardware, software, training), awareness raising and capacity building (currently only) for the banking sector on the use of the registries of secured transactions, moveable (motorbikes etc.) and non-moveable (land) assets as collateral.	IFC
BOL BTI	Financial support for accommodation and infrastructure TA to develop the BTI's overall curriculum, particularly aimed at the banking sector	Lux-Development
BOL BTI	Funding ($1.1 million), not yet specifically allocated, for TA supporting the development of a curriculum aimed at formal microfinance providers	UNCDF-MAFIPP
MFC	Strengthening capacity and supporting institutional development through funding and TA aimed at formal microfinance providers	SBFIC jointly with CARD MRI
MFC	TA on a broad range of topics, among which micro insurance, aimed at formal microfinance providers	UNCDF-MAFIPP through CARD MRI
AARMFC	Financial support from KfW to deliver training to microfinance providers in Laos	KfW
MFWG	TA to support institutional development of MFWG	SBFIC
MFWG	Technical and financial assistance for institutional development	UNCDF-MAFIPP
Network Support Organization for VMLFs	Technical and/or financial assistance to build Network Support Organizations for associated VSLFs or VMLFs, in different organizational structures, some with and some without liquidity reallocation, some with APEX function for donor funds	FIAM, CODI, ACCU, DGRV, GIZ-AFP, OCISP, ILO
Fund Inclusive Finance	Creation of funding structure for funding all program activities, including "smart subsidies" to MFIs	UNCDF-MAFIPP

382. **Micro level support: RMF providers**

LPFI	Assisting design and implementation of new MIS system. Support is to the Postal Company, the parent organization of the LPFI, which also a strategic plan will be developed which includes the LPFI	UPU
2 private DT MFIs, 5 SCUs, 2 provincial government MFIs	TA aimed at creating outreach in terms of customers (savers and borrowers), until 2014. Performance based contracts with quarterly performance measurement.	UNCDF-MAFIPP through CARD MRI
Formal MFIs	TA aimed at creating savings mobilization until 2014. Performance based contracts with quarterly performance measurement.	UNCDF-MAFIPP through CARD MRI and MFC
Formal MFIs	"Smart subsidies" to formal MFIs	UNCDF-MAFIPP through CARD MRI and MFC
WFDP (LWU)	TA and funding to build a "Good Practice", licensed Deposit-Taking microfinance provider owned and directed by the Lao Women Union	SBFIC, Rabobank Foundation
VSLFs	TA to LWU project in Vientiane Capital, Xaythani District, including some 107 villages with a total of 35,000 members	FIAM
VSLFs	TA to LWU project including 450 villages, mainly in Vientiane Capital (275 villages) but also in Luang Phrabang, Phongsaly, Champassak and Bokeo (175 villages), with a total of 70,000 members	CODI
VSLFs	TA through LCSDPA for LWU/MLSW project in Sayaboury, Borikhamsai, Savannakhet, Khammouane and Champassak province, including some 91 villages	ILO
VSLFs	TA through LCSDPA for LWU/MLSW project in Borikhamsai, Xayaboury, Savannakhet, Khammouane and Champassak province, including some 45 villages	Stone Family Foundation
VMLFs	TA to 102 villages in Champhone district, Savannakhet Province (until ultimo 2011)	DGRV
VMLFs	TA to 18 VMLFs with 4,200 members in four Northern Provinces (Xayaboury, Luang Nam Tha, Luang Phrabang and Oudomxay) until ultimo 2013	ACCU, Rabobank Foundation
VMLFs	Technical and financial assistance to 181 VMLFs with 14,400 members in Luang Nam Tha, Xayaboury and Attapeu provinces	GIZ-AFP
Start up SCU	Start up of a licensed SCU which intends to service various villages	WEC
VMLFs	Technical and financial assistance to some 30 VMLFs in Borikhamsay province	Lux Development
VMLFs	Technical and financial assistance to VMLFs in Oudomxay province in Oudomxay Community Initiatives Support Project with the ultimate goal of	Lux Development, IFAD, WFP

	formalizing an informal association of VMLFs	
VSLFs	Creation and TA to VSLFs as part of an overall multi-sector “Area Development Program “, duration 16 years.	World Vision
VMLFs	Creation and TA to VMLFs as part of the obligation to compensate affected villagers for loss of livelihood	Hydropower and Mining companies: NTPC; THPC; PBMC; Sepon Mining Company etc.

383. **General and peripheral support**

WB	Fifth Poverty Reduction Support Operation Program: Lao government’s budget support in the amount of $20 million, based on a set of 8 triggers, one of which was the creation of a Microfinance Decree
GTZ HRD-ME	TA to Private Sector Development, focus on support to SMEPDO office and implementation SMEPDO strategy TA to Labor Market-Oriented Integrated Vocational Education and Training
IFC	Improving the investment climate: work with the Enterprise Registry Office and MIC on improving legal and regulatory frameworks for establishing and operating a business, and streamlining investment procedures
EU	TA to the government in simplifying regulations concerning business registration, licensing, investment and trade, including WTO accession
UNDP	ASEAN support project, Integration into International Trading System project

D. ADB's Microfinance Development Strategy

384. **ADB assistance in line with ADB's Microfinance Development Strategy.** Possible ADB support to development of the Lao RMF sector will be embedded in ADB's overall Microfinance Development Strategy, which has been based on lessons learned by ADB during its engagement in RMF sector development in different countries over the last 11 years (ADB 2000). Among these, are lessons with immediate relevance for the current situation in the Lao PDR:

385. **ADB's Microfinance Development Strategy: Overall lessons learned** ADB's main lessons learned and consequential principles for MF development can be summarized in the following bullet points:

- In order to achieve maximum development impact and sustainable results a financial systems approach should be adopted, emphasizing the relevance of an enabling policy environment, of the financial infrastructure, and of sustainable financial services providers with a demand oriented approach, offering a range of financial services and not just credit;
- Low-income households need financial services with characteristics that meet their demand and are looking at overall benefits and overall costs, not just at interest rates;
- RMF clients are best served by a broad range of institutions that are committed to achieving outreach in the lower RMF segment based on sustainability;
- Demand for savings services is more profound than for credit and savings have significant impact on institutional sustainability and poverty reduction.

386. **Objective: permanent access.** The objective of ADB's Microfinance Development Strategy is aligned with that of the Lao PDR's Policy Statement for the Development of a Sustainable RMF sector: To ensure permanent access to institutional financial service provision to the majority of poor and low-income households, and their micro enterprises, through the development of sustainable microfinance systems (ADB 2000).

387. **Strategy: systems development.** In order to ensure access to finance for poor and low-income households and their micro enterprises, ADB's microfinance development strategy aims to support the development of sustainable microfinance systems capable of providing diverse, high-quality services.

388. **Sequencing of strategic steps.** ADB's Microfinance Development Strategy has a logical sequence of a coherent set of steps to achieve the objective given in the previous paragraph.

1st. Creating a conducive policy environment.

In ADB's strategic approach, commitment of a government to creating a conducive policy environment is a condition that needs to be met before any further support to RMF development can be given. ADB's approach focuses on interest rate reforms, on redefining the role of the central bank and state-owned banks, and on non-financial policies such as agricultural pricing, taxation and procedural constraints related to facilitation of private sector participation. In order for the policy reforms to be able to be carried out effectively, commitment to and ownership of the reforms is sought for also in Laos, based on the long-term partnership with ADB. As a consequence, close consultation with all major stakeholders at the right political level is required.

2nd. Developing financial infrastructure

Following ample RMF policy reforms ADB's support focuses on critical infrastructural elements. Example are assistance to the development of information systems and training facilities, to the creation of a regulatory setting that allows for financial innovations, to connectivity between semi-formal providers and the formal sector, and generally to the emergence of a diverse set of dynamic institutions.

3rd. Building viable institutions: Institutional Development

ADB focuses largely on existing RMF providers and on the restructuring of agricultural or rural development banks in case they undermine development of a sustainable sector. The support focuses on mobilizing public resources (deposits) and generally on providing demand-oriented, flexible products at minimal overall costs for both institution and clients.

4th. Supporting pro-poor innovations

ADB can take on the role of investing in the development of pro-poor innovations and technologies through pilot projects, as these projects are sometimes to big and risky for private institutions. The support will aim at delivery mechanisms, pro-poor products and linkages between formal and informal service providers.

5th. Supporting social intermediation

Support aimed at improving the capacity for the poor to actively participate in microfinance markets, which could include awareness building programs, information dissemination, financial literacy and consumer protection.

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Appendix 2. List of People interviewed

No	Institution, position	Name	E-mail / Phone
1	Bank of LaoPDR International Relations Department	Mr Phanthaboun Sayaphet Deputy-Director General, Director PMC ADB TA 7500	phansayaphet@yahoo.com
2	Bank of Lao PDR Financial Institution Supervision Department	Dr Akhom Phraseuth Acting-Director General	akhom@bol.gov.la
3	Bank of Lao PDR Financial Institution Supervision Department	Mr Amphone Aliyavongsing Deputy-Directo General, Responsible in FISD for ADB 7500, component 2 and for GIZ AFP program	aliyavongsing@bol.gov.la aliyavongsing@gmail.com
4	BOL, FISD, Legal Division Technical officer BOL counterpart for ADB TA 7500, component 2	Ms Bouathong Khensabab (Noy)	noy_keo@hotmail.com
5	BOL, FISD Staff of all four divisions		
6	Bank of Lao PDR, Banking Institute	Mrs Khampha Panemalaythong General Director	kpapmlt@bibol.edu.la
7	Bank of Lao PDR Financial-Accounting Department	Mr Phanethong Kongvongsa Deputy Director-General and member of IT-Promotion Systems Committee	ptkongvongsa@bol.gov.la
8	Bank of Lao PDR International Relations Department	Mrs Daomanivone Vilayvieng, Deputy-Director ASEAN Division	dao_vilayvieng@hotmail.com
9	Bank fo Lao PDR Depositor Protection Fund	Mr Santy Phonmeuanglao Acting-Director General	Santyhang@yahoo.com
10	Bank fo Lao PDR Depositor Protection Fund	Mrs Bouapha Lor Deputy Managing-Director	bouapha59@hotmail.com
11	ADB, LRM Economics Officer	Mr. Soulinthone Leuangkhamsing	sleuangkhamsing@adb.org
12	Asian Development Bank Office of Regional Economic Integration Financial Sector Team Principal Finance Sector Specialist (Rural & Microfinance)	Mr Qifeng Zhang	qzhang@adb.org

No	Institution, position	Name	E-mail / Phone
13	ADB, SERD Senior. Social Development Specialist (staffconsultant)	Mrs Elizabeth Mann	emann.consultant@adb.org
14	ADB, LRM Senior Project Officer (Environment and Natural Resources)	Mrs Sisavanh Phanouvong	sphanouvong@adb.org
15	ADB TA 7500, component 1 on Banking Supervision International Consultant	Mr Roger Kronenberg	roger.kronenberg@gmail.com
16	ADB TA 7500, component 1 on Banking Supervision International Consultant	Mr James Gianetto	james@cardinternational.com.hk
17	ADB Loan 2253, component B Capacity Building APB IBA and Team Leader for SMEC consultants	Mr Reynaldo Feria	feriarp@gmail.com
18	Deputy-Teamleader of ADB project in Laos, "Catalyzing Microfinance for the Poor" (JFPR 9095)	Mr Shane Nichols	snichols@worlded.org.au
19	The World Bank Lao PDR office Senior Economist	Mrs. Genevieve Boyreau	gboyreau@worldbank.org
20	The World Bank Senior Financial Sector Specialist East Asia and Pacific Region Responsible for Investment Climate Assessment of the Lao PDR 2011	Mrs Nataliya Mylenko	nmylenko@worldbank.org
21	UNCDF Senior Technical Advisor Inclusive Finance Responsible for AFIP program	Mr Feisal Hussain	feisal.hussain@uncdf.org
22	UNCDF, AFIP program consultant	Mrs Sinipha Khamphoui	sinipha_khamphoui@yahoo.com
23	GIZ-AFP project Team Leader	Mr Klaus Prochaska	klaus.prochaska@gtz.de
24	GIZ-AFP project Microfinance Junior-Expert	Mr Artjom Wolf	artjom.wolf@gtz.de
25	GIZ-AFP project National Microfinance advisor	Mr Bandith Sisoukda	bandith.sisoukda@gtz.de
26	GIZ AFP project Consultant, author of the	Mr Mark Flaming of Frontier Ventures	markflaming@yahoo.com

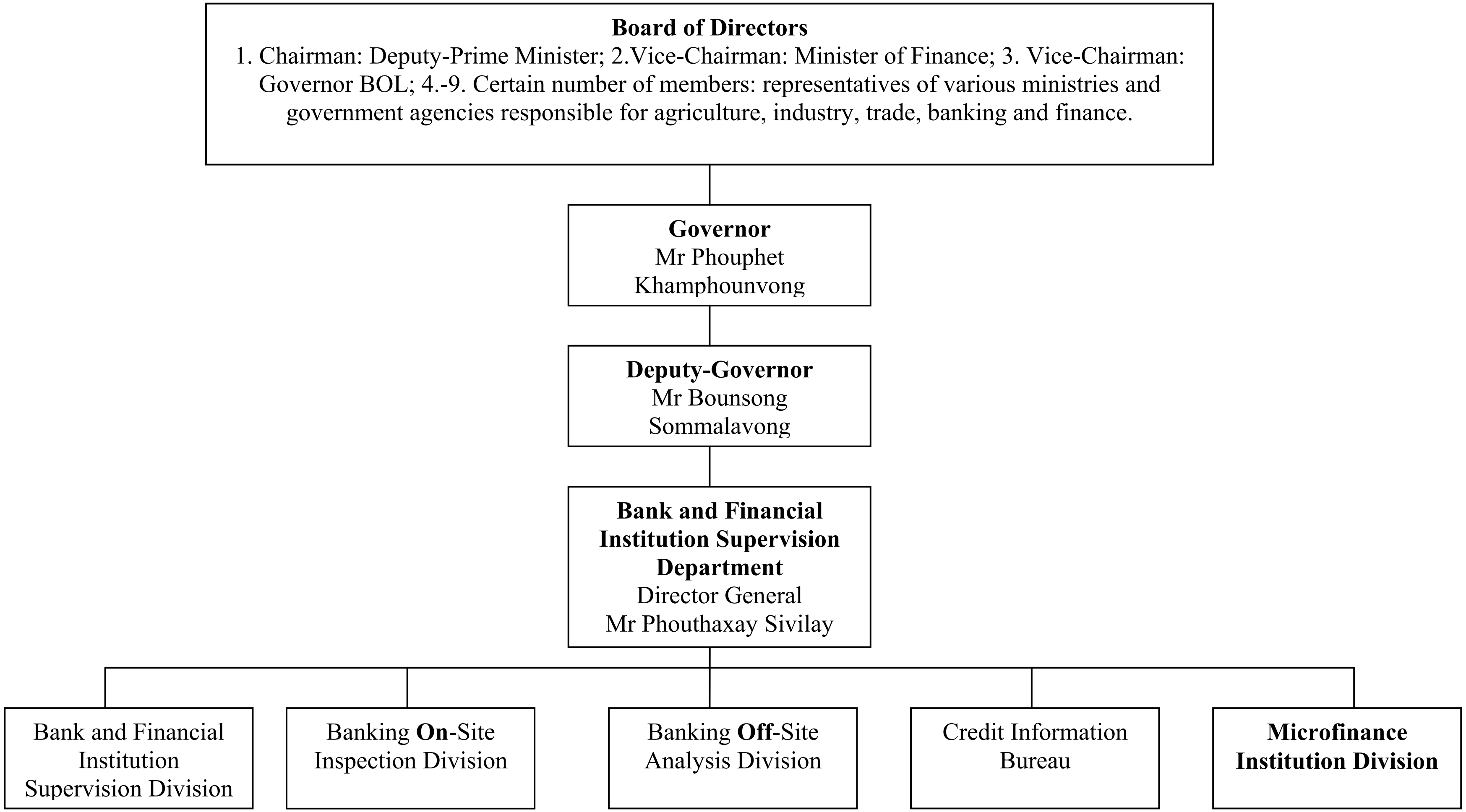
No	Institution, position	Name	E-mail / Phone
	“Regulation and Supervision Diagnostic on Access to Finance in the Lao PDR”		
27	GIZ-AFP project Team-Leader on consultancy to building a MIS and to build capacity on MFI supervision	Mr George Gregorash	ggregorash@aol.com
28	KfW, Senior Projectmanager Asia. Responsible for KfW’s contribution to the AFP project Evaluator of the GIZ-AFP project	Dr. Dirk Steinwand	Dirk.Steinwand@kfw.de
29	IFC Project Manager Access to Finance for the Lao PDR and Cambodia	Mr Hourn Thy	hthy@ifc.org
30	IFC Project Officer, Access to Finance Lao PDR	Ms Viengxay Praphasiri	vpraphasiri@ifc.org
31	CIB development for European Commission (SME Development program, TA unit) and IFC (Financial Infrastructure project, Mekong Region) Consultant, Credit Bureau Expert	Mr Hung Ngovandan	hngovandan@ifc.org
32	CIB development for European Commission (SME Development program, TA unit) and IFC (Financial Infrastructure project, Mekong Region) Consultant, Credit Bureau IT Expert	Mr Denver Vender	denvervender@gmail.com
33	Savings Bank Foundation for International Cooperation Country representative for the Lao PDR & advisor to the Lao Women’s Union onwed MFI called “Women & Family Development Fund”	Mr Bernd Werthenbach	bwerthenbach@yahoo.com
34	University of Cologne Development Research Center Professor Financial Systems	Professor Dr. Hans Dieter Seibel	seibel@uni-koeln.de

No	Institution, position	Name	E-mail / Phone
	Development and Microfinance Author of study into Village Banks in the Lao PDR (2010) Consultant for GIZ-AFP program on Rural and Microfinance Statistics 2009 (2011)		
35	CARD MRI Director CARD International Group	Mrs. Marlyn Magampon-Manila	cardmriinternational@mfclao.com
36	CARD MRI Development Insitute Training Director	Mr Edzel Ramos	Edzel.ramos@cardbankph.com
37	Prime Minister's Office Lao National Leading Committee for Rural Development and Poverty Eradication Director-General	Mr Kongkeo Vongpaseuth	cpmokkv@hotmail.com
38	Lao Women's Union Development Department Deputy-Director	Mrs Kaysamy Latvilayvong	Kaysamy_2005@hotmail.com
39	Ministry of Finance Fiscal Policy Department Deputy Director-General	Mr Bounthom Lomany	021-900969
40	Ministry of Finance ASEAN-AFTA Division Deputy-Director	Mr Phanomphone Keovongvichith	phanomk@mof.gov.la
41	Ministry of Finance Finance Statistics Division Director	Mrs Chanhsouk Thammavong	chansouk@mof.gov.la
42	Ministry of Planning and Investment Department of Statistics	Mrs Sulaphanh Phimphaphongsavath Director of Service Division	Sulaphanh_2004@yahoo.com
43	Ministry of Health Department of Planning & Finance Acting-Director General	Dr. Khampheth Manivong	khamphethm@yahoo.com
44	Lao Social Security Organisation	Mr Khamphouang Inthaseng Director	ssowebmail@ssolao.gov.la
45	CSCC group (company responsible for development of IT side of payment system in BOL) Chair	Mrs. Samsivath Keobounphanh	Via Bank of Lao PDR, Mr Phanethong Kongvongsa

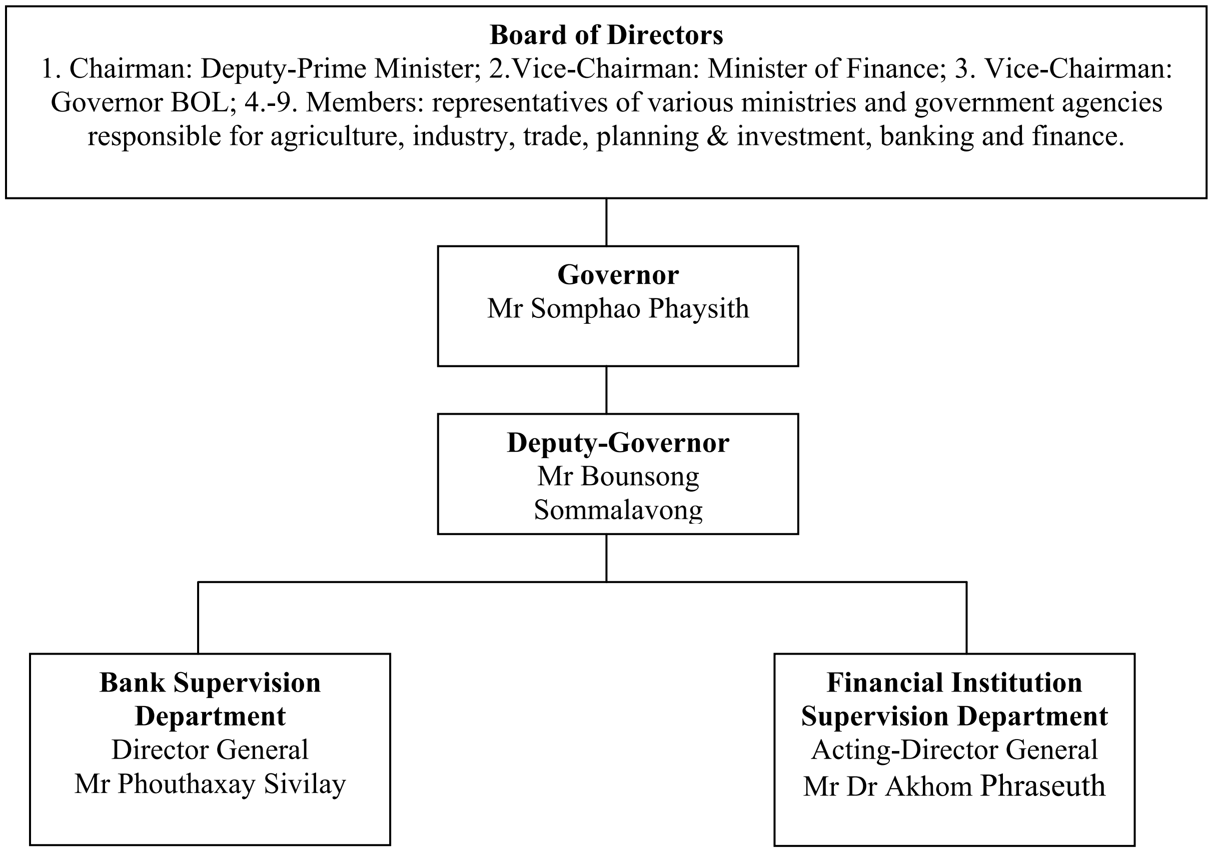
No	Institution, position	Name	E-mail / Phone
46	Consultancy Associates Ltd (main implementers of IT side of payment system within BOL) Principal Consultant	Mr Anthony Lee	anthony@calglobal.com
47	Lao Postal Financial Institution	Mrs Phonemany Luanglath Deputy-Director	Phone: 021-253061
48	Lao Telecom Finance Department Manager	Mr Bounly Amnoyphone	bounly@laotel.com
49	Lao Telecom IT Department Deputy Manager	Mr Itthipon Worawong	itthipon@laotel.com
50	Lao Telecom Accounting Department Manager	Mrs Somchit Leuangvansay	somchit@laotel.com
51	Young Entrepeneurs Association of Laos (part of Youth Union Center of Lao People's Revolutionary Youth Union) Acting-President	Mrs Valy Vetsaphong	valyvesaphong@hotmail.com
52	Tigo Laos (Millicom Lao Ltd) Manager Internet and Value Added services	Mr Denis Lagarde	denis.lagarde@tigolao.com
53	Assurance General du Laos (Allianz) CEO & MD	Mr Guy Apovy	guy.apovy@agl-allianz.com
54	Agricultural Promotion Bank General Director	Mr Bouangeunh Phongsavanth	021-241389
55	Agricultural Promotion Bank Head of Planning & International Relations Division	Mr Kongsy Thongphouvong	pirapb@yahoo.com
56	Agricultural Promotion Bank International Relations Division	Mr Khamsaveng Keoboualapha	Kham_1_pdr@hotmail.com
57	Agricultural Promotion Bank Chief of Credit & Marketing Division	Mr. Bounnyou Meuangmahavong	bounyouapb@yahoo.com
58	Lao Bankers Association	Mr Sounthone Sinthapaseuth Secretary General	s.sinth@ldb.org.la
59	Lao Development Bank Head of Department of Credit	Mr Bountern Keovilayvong	kbountern@ldblao.com

No	Institution, position	Name	E-mail / Phone
60	ACLEDA Bank Lao Ltd. CEO & MD	Mr Narin Phon	narin@acledabank.com.la
61	ACLEDA Bank Lao Ltd. Manager Legal Department & Company	Mr Boranchanborath Chen	borath@acledabank.com.la
62	ACLEDA Bank Lao Ltd. Manager Treasury & Operations Department	Mr Vathanak Leng	vathanak@acledabank.com.la
63	Phongsavanh Bank Advisor to Senior Management	Mr Sengxay Phousinghoa	sengxayph@phongsavanhbank.com
64	TMB Bank Head of Debt Capital Markets Capital Markets Group	Mrs Poonyapa Thiensiripipat	Poonyapa.thi@tmbbank.com
65	Founder and President of the licensed SCUs “Fonds Cooperatif Ltd” and “Credit Cooperative for Support of Small Production Units”	Dr. Sisaliao Svengsuksa	svengpcy@gmail.com
66	Owner/Director of Ekphattanna DT MFI Owner/Director of the Microfinance Center	Mr Somphone Sisenglath	somphone.s@mfclao.com
67	Microfinance Working Group for the Lao PDR Co-Chair	Mrs Ursula Hammerich	uhammerich@yahoo.com
68	Bank of Lao PDR, Banking Institute Teacher Microfinance	Mr Phomsy Vongphachanh	phomsybi@gmail.com
69	Savings Banks’ Foundation for International Cooperation Project Manager Lao PDR	Mrs Nicole Brand	Nicole.Brand@sparkassenstiftung.de
70	Helvetas (Swiss Development cooperation agency) CTA Enhanced Milled Rice Production in the Lao PDR	Mr Andrew Wilson	andrew.wilson@helvetas.org
71	World Remittance Database Specialist Remittances and Development Program of Inter-American Dialogue	Dr. Manuel Orozco	morozco@thedialogue.org
72	ADB Northern Region Sustainable Livelihoods through Livestock Development Project Team leader study into Institutionalisation of microfinance component (village livelihood funds)	Mr Robert Hickson	Robert@microfinanceservices.com

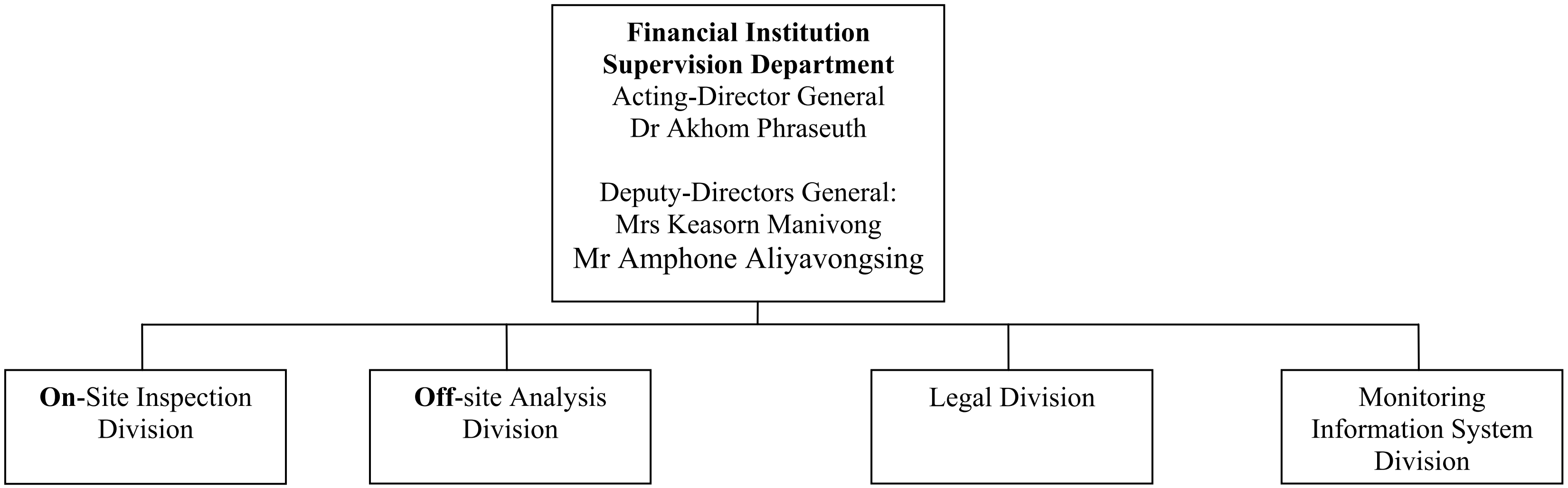
Appendix 3. Microfinance Institution division (situation before 27 August 2010)



Appendix 4. Financial Institution Supervision Department (situation starting 27 August 2010)



Appendix 5. Financial Institution Supervision Department and its four divisions



Appendix 6. APEX Feasibility Study

FEASIBILITY STUDY REPORT - APEX MICROFINANCE INSTITUTION IN THE LAO PDR

Catalyzing Microfinance for the Poor Project (CMP/JFPR9095)
Original version: Guy Winship, July 2009
Revised version: Shane Nichols, January 2010[288]

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1. INTRODUCTION

1.1. Background

In the initial design for ADB's current program of microfinance support to the Lao PDR[289] consideration was given to ADB providing support to the conceptualization and possible establishment of a microfinance apex institution (referred to interchangeably as a "national microfinance institution" and as an "apex (microfinance) institution" in later ADB documents). The compilation of terms of reference for a feasibility study for an apex microfinance institution was therefore included in the terms of reference for the Catalyzing Microfinance for the Poor project.[290]

The data and understanding of the microfinance sector in the Lao PDR that underpins this concept note is based on a range of information, reports, interviews and experiences. This includes specific insights gleaned from joint institutional assessments undertaken by the CMP project of 23 leading microfinance institutions in Laos; meetings with key sector stakeholders; participation in the Microfinance Working Group; experience implementing working with MFIs and sector stakeholders under the CMP project over a two-year period; collaboration and discussions with BoL microfinance unit; reviews of studies and documents on the Lao microfinance sector, international experience; and a review of the best practice principles in the design and implementation of apex microfinance institutions recommended by CGAP and others. Based on this understanding, initial concern was raised by the CMP team as to the appropriateness of establishing an apex microfinance institution in Laos at present. For this and other reasons a two-phase approach to the study was agreed, with a more generic and high-level assessment in stage one, and a more detailed study to be undertaken thereafter should this be required.

This concept note therefore focuses on stage A in the Scope of Work, namely to "investigate and recommend the most appropriate option for the future of the Microfinance Fund Management Unit (MFFMU)", outlining the prospects of various options including an apex microfinance institution. The development of a prospectus for the proposed option is not recommended at this time given the conclusions of this concept paper. Annex A provides both the original task reference as well as the revised and approved Scope of Work in this regard.

1.2. Approach to feasibility study

The methodological approach to this feasibility study was for the CMP Team Leader to consider, develop and obtain approval for the proposed Scope of Work (see Annex A); to research and review current best practices in the design and establishment of microfinance Apex Institutions internationally (see selected references in Annex B); to interview key stakeholders during an in-country field visit in April 2009 (interviews with 34 people from 23 agencies were undertaken - see

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[288] Chapters 3.1 and 5 were substantially revised following ADB comments on the original version
[289] Refer for example to the **Grant Implementation Manual**, Appendix 12, page 77, which states: "Depending on need and evolution of the sector, the MFFMU and MFF may eventually be transformed into a national level MFI or "apex institution" to wholesale funds to MFIs—such a transformation would be the subject of a study…"
[290] "Laos" and "the Lao PDR" are used interchangeably in this report

Annex C); and finally to compile and discuss a draft of this concept note with BoL, ADB, and other key stakeholders. The translated comments from BoL are provided in Annex E.

1.3. Aim and Outline of this Concept Note

The aims of this concept are as follows:-

i. To explain (section 2) **what is meant by "Apex Microfinance Institution[291]"** internationally and in the Lao PDR microfinance context. In discussing options with key stakeholders in the Lao PDR, it became apparent that there is negligible experience and little understanding of what is meant by an apex (microfinance) institution, and hence the need to outline briefly what is meant by "apex institution" in the Lao PDR context.
ii. To identify (section 3) - in very broad terms - **the support needs of the microfinance sector** in the Lao PDR.
iii. To outline (section 4) **what possible institutional options need to be considered** in meeting the support needs of the microfinance sector, **and to briefly discuss the advantages and disadvantages of each** of these.
iv. To **recommend the option considered most attainable, in line with international best practice** (section 5).

2. WHAT IS AN APEX INSTITUTION IN THE MICROFINANCE CONTEXT?[292]

2.1. What is an apex microfinance institution?

An apex institution in the microfinance context is a second-tier (also referred to as a "wholesale") organization that channels funding in the form of grants, loans and/or guarantees to numerous microfinance institutions (also referred to as "retailers") in a single country or region. In practice such funding has generally been aimed at raising levels of access to capital given various challenges in this being obtained from market/commercial sources. Improving financial inclusion, outreach and MFI performance, and other social objectives also underpin such support, and hence related costs have often been subsidized by donors. While funding may be provided with or without supporting training and/or technical services, the general focus of an apex institution in the microfinance context has been on channeling funding to relevant microfinance institution service providers invariably based on agreed selection, reporting and other criteria to ensure specific performance standards at these MFIs are met. Finally by "institution" there is an understanding that such services are provided in the framework of a (usually local) organization with all requisite governance, compliance, management, MIS and related internal control systems being in place, whatever the legal structure and business/funding model utilized.

2.2. Why are apex microfinance institutions considered attractive in supporting microfinance in a country?

Apex microfinance institutions can be appropriate vehicles to deliver funding, along with training and technical services, in countries where MFIs are too small or too numerous for direct funding relationships. These apex institutions can be attractive to governments, donors and others because they permit supporters to pass the complex and often lengthy task of MFI selection and due diligence, and monitoring of partner performance, to a local institution that is assumed to have the required skills.

A critical related consideration is of course the number of MFIs seeking funding support and the scale of such funding: simply put, how many MFIs have valid funding needs that are not or cannot be met directly by donors or other means? And how large are the funding needs of these MFIs? Current

[291] Referred to also as an "apex institution", or simply as an "apex"
[292] Much of the discussion here is drawn from various CGAP papers, especially Occasional Papers 5 & 6, referenced in Annex B.

external[293] funding sources are focused on multi-lateral, bi-lateral, international foundations and NGOs donors, and locally by private and public equity and through government grants. Key here is, if indeed there is a funding shortfall, would this be best met through the design and establishment of an apex microfinance institution?

Unfortunately many apex microfinance institutions internationally have not performed to expected levels, with the majority having produced disappointing results (per CGAP Occasional Paper 5, page 1). This is most often because they were set up in countries without a critical mass of good MFIs with the capacity to absorb such apex funding, which is indeed currently the case in the Lao PDR.

It should be noted that international best practice indicates that a move towards more market driven funding sources, such as commercial and quasi-commercial (e.g. social investment) lending, where external funding is needed by MFIs, would (other factors aside) be preferable as it would likely better enable scale to be attained. Moreover sourcing funding from the private sector may increase equality in funding access amongst MFIs, in that it is likely to be based less on what is often subjective assessment by donors. It is often argued that an apex institution can support moves along the continuum from grant to increasing commercial funding over time. Such a move to commercial or even quasi-commercial funding clearly remains a long way off for the Laos microfinance sector (see section 3 below also).

2.3. What are the characteristics of a good apex institution?

Recognized best practice[294] for apex microfinance institutions indicates seven key characteristics. In no particular order these are:[295]

	Key Characteristics of Good Apex institutions
1	The apex institution has a clear goal of **nurturing the development of sustainable microfinance providers,** including banks where they provide microfinance services. Evidence shows that developing a group of permanent, sustainable MFIs - and not maximizing the number of MFIs - is the most effective way to expand the number of poor people served.
2	The apex is **politically independent**, with a strong board able to protect the institution from political intervention, ensuring that management can make decisions on technical grounds and not on other bases.
3	The apex receives funding based on a **realistic assessment of the number of qualified MFIs** in the country or region that can absorb apex funding.
4	Apex funding of MFIs is based on **clear selection criteria**, such as portfolio quality, depth of outreach, quality of management and governing board, and progress towards financial sustainability. The apex must have the authority to discontinue funding to MFIs that fail to meet these criteria.
5	Apex funding is **tailored to the cash flow patterns and planning needs of MFIs**, not to pre-set or supply-driven disbursement plans.
6	The apex monitors MFIs on the basis of a **few, precisely defined performance targets** that are seriously enforced.
7	Apex **management is of very high quality**, possessing a blend of senior microfinance expertise, managerial and financial skills, and integrity.

2.4. Common challenges faced by apex institutions[296]:

⇒ Apex institution designs invariably overestimate the number of MFIs that can meet sound selection and ongoing performance criteria. The number of viable MFIs is a genuine constraint for most apexes. Even when PKSF[297], an apex institution in the foremost

[293] "External" here refers to non-institutional derived funding sources. By far the largest "internal" source of funding is savings mobilization and, to a lesser extent, equity. This meets the bulk of funding needs for many MFIs in Lao PDR.
[294] Per CGAP, see http://www.cgap.org/p/site/c/template.rc/1.11.2746/
[295] From CGAP Occasional Paper number 5, page 1
[296] From CGAP Occasional Paper number 5, pages 2 and 3
[297] Palli Karma-Sahayak Foundation; see http://www.pksf-bd.org/ for further information

microfinance market of Bangladesh, used broad eligibility criteria, only 10% of initial applicants qualified for funding. Apex institutions in Kenya (K-Rep), Colombia (Fundacion Carvajal), Pakistan (PPAF) and in other countries have all had similar experiences, with significantly greater funding available than there were qualified MFI recipients.

⇒ Replicating a 'successful' apex model from one country in another context (country or region) is rarely successful. Studies[298] of over 28 apex institutions worldwide drew the clear conclusion that no single institutional or methodological approach was appropriate in all contexts or countries.

⇒ Donors and other stakeholders pressure apexes to disburse funds quickly. Apex institutions that are serious about microfinance partner selection and performance criteria often cannot disburse funds quickly because they typically find fewer qualified MFIs than were anticipated. Other apexes succumb to disbursement pressure and fund low quality MFIs, with all resultant risk and performance implications.

⇒ Political pressure adversely affects MFI funding decisions. Government involvement in an apex institution can compromise its mission by inducing the apex to disburse funds to unqualified MFIs.

⇒ Apex institutions rarely build bridges between MFIs and commercial funding sources in practice, despite continuing belief by many in the sector that this can be done. Some stakeholders assume apexes will pave the way for commercial funding to MFIs, but this goal is rarely included in the apex mission. The availability of cheaper apex funding is, in fact, more likely to reduce incentives for MFIs to seek commercial funding.

3. SUPPORT NEEDS OF THE MICROFINANCE SECTOR IN THE LAO PDR

The microfinance sector in Laos is nascent, with few competent microfinance institutions, even though recent impetus has had some positive indications. There are currently no pro-poor best practice profitable microfinance institutions in operation in Laos, and no microfinance institutions have attained commonly agreed international best practice benchmarks. The support needs of the microfinance sector are clearly then both wide and deep. The embryonic nature of the microfinance sector in Laos and the related character of the support needs can be seen in various reports[299]. This is corroborated by the work of the CMP project, including detailed institutional assessments of the leading 23 microfinance institutions country-wide.

The support needs of the microfinance sector cover the macro, meso and micro levels. This includes support in the compliance, regulation and supervision areas at the **macro level**; support in establishing microfinance support capacity of individuals and institutions, including auditors, trainers, lenders, technical advisors and apex institutions at the **meso level**; and well functioning and sustainable pro-poor microfinance institutions at the **micro level**. At the **beneficiary level** building the capacity of microfinance clients in such areas as financial literacy and basic business management skills is also an important area of sector support. It is critical to note that support to the microfinance sector would best focus on building a strong and vibrant microfinance sector rather than on an individual or even a few microfinance institutions. Nevertheless the focus of the support needs in this concept note is on how an apex institution can meet the funding and other support needs of microfinance institutions, which would in our opinion constitute the most immediate component need of the microfinance sector in terms of building a viable and vibrant microfinance sector in Laos in the longer-term.

The support needs of the current cadre of larger and regulated (or potentially regulated)[300] microfinance institutions in Laos can be broadly categorized into three areas: funding, training, and technical assistance – as outlined in the following sections.

[298] From CGAP Occasional paper no. 6

[299] Such as "Training needs and Delivery Strategy for the Microfinance Sector of Lao PDR" by Tillman Bruett, internal CMP reports

[300] The reference here is to formal and semi-formal MFIs, including all those that fall within the regulatory framework, including all deposit-taking MFIs (shareholder and member owned) and Credit and Savings Co-operatives: but specifically

3.1. Funding

The continuum of funding needs of MFIs ranges from grant to grant matching to semi-commercial lending (initially with guarantee and/or other support) and, in the long term, to commercial lending (with and then without guarantee support). Current funding support to Lao microfinance institutions is almost exclusively grant and donor based, reflecting current and historic need, with no MFIs accessing commercial or even quasi-commercial funding. Some discussion[301] in the sector would indicate that the take-up of commercial loan funding is unlikely to take place in the short to medium term (say less than the next three years at least). In order to estimate future MFI demand for debt and grant funding, the following section uses historical data to develop a theoretical estimation of future demand under various scenarios.

3.1.1. Theoretical estimation of MFI demand for debt and grant funding

Number of registered MFIs

The Bank of Lao PDR commenced active registration of MFIs following the issue of a microfinance decree in 2005[302], and this was bolstered by the issuance of new MF regulations in mid 2008. Historical levels of new MFI regulations, and projections for 2010, can be seen in Table 1 below.

Table 1 - Historical Growth in MFI registrations

Year	No. of registered MFIs at start of year	No. of new MFIs registered during year	No. of registered MFIs at end of year	Average annual growth in registrations
2008	15	7	22	47%
2009	22	6	28	27%

After a peak during 2008 when many existing MFIs decided to register under the new regulations, the number reduced slightly to six new registrations in 2009. This level is both a product of interest in MFI registration and BoL willingness and ability to approve new applicants. Most existing MFIs are now registered, and so future sector growth will largely be restricted to new entrants and transforming village funds. Given that a large number of registered MFIs are not compliant with the regulations, there is potential for some de-registrations in future. Net growth in registrations is estimated to be in the order of five MFIs per year.

Asset base

Estimates of demand for capital can be determined through analysis of MFI balance sheets. Table 2 presents data on aggregate and average balance sheets of 16 MFIs that report to the CMP project.

Table 2 - Aggregate asset base of 16 existing MFIs at 30 September 2009

Aggregate of 16 MFIs: (MFIs reporting to CMP)

ASSETS	US$	LIABILITIES & EQUITY	US$
Gross Loan Portfolio	2,278,592	Customer Deposits	1,501,236
Cash & Investments	810,645	Other Liabilities	892,094
Other Assets	812,291	Equity	1,508,198

excludes the large number of small village savings and credit groups – also referred to as village revolving funds or village banks – which fall outside the scope of the CMPJFPR9095 project.

[301] Refer to the Microfinance Working Group in Lao PDR, see http://www.mfwglaopdr.org/

[302] There were *ad hoc* registrations prior to this time – but there was no clearly defined mechanism for registration nor active promotion of registration by BoL

Total Assets	3,901,528	Total Liabilities & Equity	3,901,528

Average per MFI:

ASSETS	US$	LIABILITIES & EQUITY	US$
Gross Loan Portfolio	142,412	Customer Deposits	93,827
Cash & Investments	50,665	Other Liabilities	55,756
Other Assets	50,768	Equity	94,262
Total Assets	**243,845**	**Total Liabilities & Equity**	**243,845**

* Exchange rate applied: US$1 = 8492 Lao Kip (LAK)

This table indicates that the average Lao MFI has a gross loan portfolio of approximately $142,000, and approximately $244,000 in total assets. The accuracy of this data is questionable given that 7 of the 16 MFIs submitted balance sheets that did not balance (minor adjustments were made to asset and equity figures to achieve a balance in the tables above). This data pertains to 16 of 28 registered MFIs.

Analysis of these 16 MFI balance sheets indicates that MFIs fall into three main groupings:

i. 60% are **small MFIs** - typically Savings and Credit Unions (SCUs) with some start-up Non Deposit-Taking MFIs (NDTMFIs), with total assets less than $100k;
ii. 30% are **medium-sized MFIs** - typically NDTMFIs with one large SCU and a start-up Deposit-Taking MFI (DTMFI) with total assets ranging $100k-$399k; and
iii. 10% are **larger MFIs** - typically DTMFIs with more than $400k in total assets.

MFIs are well capitalised, with an average equity / total assets ratio of 39%. This suggests that there is room for additional debt - provided that they can meet profitability, portfolio quality and any other funder requirements.

Portfolio Quality

Donors that follow good practices, APEX agencies and all commercial funders of MFIs require that the recipient MFI have good portfolio quality in order to be eligible for loans or grants to fund expansion, and this is commonly indicated by a PAR(30) level of less than 5%. Funding portfolio growth in MFIs that have weak portfolio quality can serve to magnify existing problems, and so having PAR(30) < 5% is a standard eligibility criterion.

Table 3 provides data on the number of Lao MFIs that fell into different PAR(30) categories, as at 30 September 2009.

Table 3 - Portfolio at Risk Levels among existing MFIs at 30 September 2009

Portfolio at Risk (30 days)	No. of MFIs (30 September 09)	% of all MFIs
0-4.9%	6	**35%**
5.0 - 9.9%	5	29%
10.0 - 14.9%	2	12%
15%+	4	24%
Total	17	100%

Analysis of portfolio quality Lao MFIs indicates that at 30 September 2009 only 35% of MFIs met the PAR(30)<5% criterion. This suggests that no more than 35% of Lao MFIs would be eligible for funding for portfolio growth (either through a grant or loan) if this criterion were enforced. High delinquency levels have historically been a challenge for Lao MFIs, and while the CMP project is working to address this, it would be unrealistic to expect these figures to undergo a significant change in the short-term. It is more likely that these figures will improve gradually over the next 5-10 years. Larger, more professional MFIs are considered more likely to meet this requirement in the medium term than smaller agencies.

Profitability
Another criterion used by funders of MFIs (especially those providing debt financing) is that the MFI be profitable - or at least approaching profitability. In Table 4 below, profitability is indicated by Operational Self-Sufficiency levels of greater than 100%.

Table 4 - Operational Self-Sufficiency among existing MFIs

Operational Self-Sufficiency	No. of MFIs (30 September 09)	% of all MFIs
100%+	11	**64%**
80-99.9%	3	18%
60-79.9%	0	0%
<60%	3	18%
Total	17	100%

Here it can be seen that 64% of Lao MFIs reported a surplus in the year to 30 September 2009. In most cases depreciation of fixed assets is recorded at year-end and so this figure is likely to be over-stated. If profitability were used as a criterion for APEX funding, approximately 50 to 60% of MFIs would meet this requirement. This may increase to no more than 80% of all MFIs if those approaching profitability (i.e. in the range 80-99.9% OSS) were included.

It should be noted that those MFIs not meeting these criteria may be eligible for grants for training and other forms of institutional support, depending on the requirements and conditions attached.

Experience of funding demand and eligibility under CMP
The CMP project attracted substantial grant funding applications but found limited absorption capacity amongst MFI applicants. MFIs requested funds mainly for investment in the portfolio but the awarding and disbursement of grants for this purpose was constrained by weak portfolio quality. Grant sizes were also constrained by a lack of matching funds (the project requires a 1:1 match). The average grant amount approved was approximately $24,000, or approximately 10% of average total assets. Among this, approximately half was ultimately awarded for portfolio growth and half for training and other institutional support. Details are provided in Table 5.

Table 5 - MFI requests vs. approvals for grant funding under CMP

	Requested / Applied	Approved	Amount approved per MFI
No. of MFIs	22	21	
Grants for Loan Portfolio	614,775	233,370	11,113
Grants for other funding	362,292	276,850	13,183
Total grants	977,067	510,220	24,296

Observations and basis for theoretical demand projections
On the basis of the information and experience indicated above, we can make some observations and assumptions about likely demand and eligibility for grant and debt funding for Lao MFIs. These can be summarised as follows:

a) At the end of 2009 there were 28 registered MFIs. There have been 6-7 new registrations per year over the past two years, and most existing MFIs are now registered[303]. Taking into

[303] References in this paper to MFIs do not include the estimated 5,000 village funds that exist in Lao PDR. It remains unclear whether these funds will be required or willing to register and become regulated by BoL. This could potentially have a massive impact on demand projections. Given the uncertainties, and lack of reliable data, village funds are not included in the scope of the current study.

account the gradual maturity of the sector and the potential for some de-registrations, future growth in MFI registrations is estimated at around five per year.

b) Lao MFIs are currently meeting only a small fraction of the demand for microfinance services, in particular in rural areas[304]. For the purposes of projecting sector growth, it is therefore considered that retail demand will not present any restriction on the growth of the sector in the next 5 years (and likely much longer).
c) Average total assets of Lao MFIs reporting to CMP was $244,000 at 30 September 2009. This represents a mix of both established and newly established MFIs.
d) MFIs can broadly be classified into three categories: 60% are small MFIs with total assets up to $100k; 30% are medium-sized MFIs with total assets ranging $100k-$399k; and 10% are larger MFIs with more than $400k in total assets.
e) With an average equity / total assets ratio of 39% there is room for MFIs to take on additional debt if they can meet profitability, portfolio quality and other funder requirements.
f) Historical approvals of grants for loan portfolio under CMP equate to approximately 5% of total assets. This figure may be used to broadly represent eligible demand for debt financing, since grant eligibility requirements were similar to those of lenders. This figure of 5% of total assets was achieved in an environment of weak portfolio quality (at September 2009 only 35% of MFIs had PAR30<5%). As the situation improves over the next three to five years, demand for debt among eligible MFIs could be expected to increase.
g) The ratio of total borrowings to total assets for comparable countries in South-East Asia ranges from 22 to 33%.[305] Given the high level of donor dependence, low level of sector development, significant donor interest (provision of grant funding), and restrictions on foreign investment in Lao MFIs, this ratio is estimated to be around 20% for Lao MFIs in 3 to 5 years' time.
h) Historical approvals of grants for training and institutional support under CMP equate to approximately 5% of total assets (average grant term is approximately one year). This figure may be used to broadly represent eligibility for grant financing. Eligibility for such funding under CMP was constrained by the availability of matching funds (a 1:1 match was required). It could be assumed that as the sector grows, and more investment is enabled, the value of grants to eligible MFIs could increase to around 15% of total assets.
i) To the best of CMPs knowledge, no MFIs have externally audited financial statements, and 44% of MFIs submitted September 2009 balance sheets that do not balance. Most MFIs struggle with loan loss provisioning, depreciation, accounting for grants, and other basic accounting functions. Bank of Lao has limited supervision skills and capacity. As a result, confidence in the veracity of financial statements is low. In the absence of audited financial statements it is unlikely that any commercial or quasi-commercial lender would lend to these MFIs at the present time.
j) As at September 2009, no more than 35% of registered MFIs are both profitable (OSS>100%) and have good portfolio quality (PAR30<5%). As the sector matures and MFI management performance improves in the coming 3-5 years, the use of audit services increases, and PAR levels improve, it could be expected that around 20% of small MFIs and perhaps 50-60% of larger MFIs may meet basic eligibility requirements for debt funding. Most MFIs are likely to be interested in and eligible for grant funding.

In projecting theoretical scenarios for MFI growth and demand levels, we have taken the assumptions presented above and projected three scenarios: low, medium and high roads. Given that there is virtually no eligibility for debt financing at present (indicating no immediate need for an APEX), these scenarios are presented for a short-term window of 3 years as well as a medium-term window of 5 years. The assumptions underlying these projections are based on a very limited track record and are not robust enough to project beyond 5 years. Even these 3 and 5-year projections are made with caution and should be interpreted as theoretical only. Table 6 provides details.

[304] Refer for instance the JFPR grant proposal 2005 which summarises research into retail demand. It is outside the scope and resources of this review to assess retail demand - the focus here is on wholesale demand, based on the assumption that retail demand will not pose a constraint to sector growth in the medium term.
[305] Microfinance Information Exchange: www.themix.org

Table 6: Theoretical Projections of MFI sector growth and MFI demand for debt and grant financing

	30-Sep-09	3-years			5 years		
	Actual	Low	**Med**	High	Low	**Med**	High
No. of registered MFIs	28	37	**43**	49	43	**53**	63
- small MFIs (<$100k total assets)	60%	60%	**50%**	40%	60%	**50%**	40%
- medium MFIs ($100k-$399k total assets)	30%	30%	**35%**	40%	30%	**35%**	40%
- larger MFIs ($400k+ total assets)	10%	10%	**15%**	20%	10%	**15%**	20%
Avg. Total Assets							
- small MFIs	$50,000	$50,000	**$60,000**	$70,000	$50,000	**$60,000**	$70,000
- medium MFIs	$200,000	$200,000	**$250,000**	$300,000	$200,000	**$250,000**	$300,000
- larger MFIs	$700,000	$700,000	**$900,000**	$1,200,000	$700,000	**$1,000,000**	$1,400,000
% of MFIs eligible for debt							
- small MFIs	-	10%	**20%**	30%	10%	**20%**	30%
- medium MFIs	-	20%	**30%**	50%	30%	**40%**	50%
- larger MFIs	-	30%	**50%**	70%	50%	**60%**	70%
% of MFIs eligible for grants							
- all MFIs	80%	60%	**75%**	90%	60%	**75%**	90%
Demand							
Avg. demand for APEX debt / total assets	-	10%	**20%**	30%	10%	**20%**	30%
Avg. annual demand for APEX grants / total assets	10%	10%	**15%**	20%	10%	**15%**	20%
Est. potential demand for APEX debt (outst. bal)		$133,200	**$857,850**	$3,475,080	$240,800	**$1,388,600**	$4,997,160
Est. potential demand for APEX grants (annual)		$355,200	**$1,221,469**	$3,422,160	$412,800	**$1,594,969**	$4,853,520

Assumptions behind growth in number of registered MFIs:

- **Low:** No. of registered MFIs increases by 3 per year
- **Medium:** No. of registered MFIs increases by 5 per year
- **High:** No. of registered MFIs increases by 7 per year

Looking at the medium growth/demand scenario (considered to be the most likely of the three scenarios), we can see that demand for debt is estimated at approximately $860k in 3 years and $1.4 mill in 5 years (the high growth/demand scenario equates to $3.5m in 3 years and $5m in 5 years)[306]. This is the outstanding balance of the theoretical APEX loan portfolio. Annual levels of grant expenditure have been estimated at $1.2 million in 3 years and $1.6 million in 5 years under the medium growth/demand scenario. These figures are crude and will vary depending upon specific eligibility and funding criteria, as well as due to the natural effects of government policies, economic growth and structure, and the actions of donors and other investors. In the opinion of the reviewer, these estimated levels of debt funding are not sufficient to warrant the establishment of an APEX lending facility within the next 3 years. This low level of projected demand is compounded by weak audit, accounting & MIS support infrastructure, weak supervision capability, restrictions on foreign investment in MFIs, and a lack of government interest in establishment of an APEX lending facility.

There is a large net demand for safe and accessible monetary savings services in Laos that provides a current and likely future key funding source in the microfinance sector[307]. The financial sector is highly liquid, with aggregate loan to deposit ratios of under 50% in the banking sector. Accordingly the role of support agencies in promoting appropriate savings services is generally more important than in providing funding, and this detracts from the traditional funding role of an apex microfinance institution. This highlights the importance of having solid and sustainable microfinance institutions, and building capacity of the microfinance sector.

The lack of any track record in financial sustainability amongst MFIs in Laos produces additional risks that an apex institution would face in providing funding support. The commercial banks interviewed indicated they would be extremely reluctant to lend to MFIs without full collateral and a track record of profitability at a minimum. As was argued earlier, international best practice would generally indicate a focus on assisting microfinance institutions to move away from grant support over time towards semi-commercial funding, and in the longer term to more commercial funding sources. This would be attained primarily by building a stronger microfinance sector both in outreach and in service quality: in practice this would mean a number of sustainable microfinance institutions operating in all parts of the country and in all sectors with a focus on meeting identified client needs. Ultimately a competitive and client-focused microfinance market with a number of competing and financially sustainable microfinance institutions must be the primary vision for the sector the short to medium term. This can best be attained through a range of institution building measures, focusing on human resource capacity-building, primarily training and technical assistance to meet identified skills shortfalls amongst microfinance institution staff and governance. Simply put, over the next five years or so institutional capacity-building through training, technical assistance (or TA) and other support is considered more urgent than grant or loan funding.

3.2. Training

[306] If significant numbers of village funds were to become regulated institutions then that would have a significant impact on demand figures, and these would need to be revised.

[307] Which MFIs the proposed Depositor Protection Fund (DFP) will cover is not yet known (see Lao PDR *Financial Sector Strategy 2008*), nor is the affect this would have in shifting or mobilising deposits in either case, although it must be noted that deposit guarantees has been a significant factor in deposit decisions in other financial markets in recent years.

Training refers here to a wide range of generic and specific skills including board governance training, business and financial planning, risk management, bookkeeping and accounting skills, and a range of other areas. Support needs here vary in depth given that the current capacity levels within microfinance institutions fluctuate considerably. There is hence the need for introductory to advanced level trainings, with weighting in the short-term to the more introductory levels. Training programs must be needs-based, and structured institutional training needs assessments should be undertaken prior to any training intervention to determine the nature and scale of demand and the desirability for related training interventions. The experiences of the CMP project to date do indicate a strong need and demand for a range of training interventions, and the poor performance of most microfinance institutions in the country clearly underpins this supposition.

Measures of success of training interventions in the medium term would be increased performance by microfinance institution partners of key measures, such as operational sustainability, PAR, adherence to BoL regulatory and reporting requirements, and good governance measures. Agencies supporting the growth of the microfinance sector together with other stakeholders should determine and agree what these measures are, and how they will be reported and monitored.

Given that a well designed and resourced donor and/or government funded project should be able to provide such training, it is not apparent that an apex microfinance institution would necessarily be the most appropriate institutional vehicle in this regard.

3.3. Technical Assistance

Technical assistance refers to institution-specific capacity building programs, ideally based on an ordered assessment of the relevant microfinance institution. Such technical assistance covers areas such as management information systems (MIS), new product development, risk and Asset-Liability Management, financial management, delinquency management, board development and assessment, and staff incentive programs. The support needs here are many, but should in the short to medium term focus on ensuring there is in place a group of financially sustainable microfinance institutions. Typically the provision of technical assistance would follow the delivery of training in a particular topic, to ensure that skills developed during training are able to be applied to the context of specific MFIs and result in tangible outcomes.

Measures of success of such technical assistance support in the medium term would be increased performance of key measures by microfinance institution partners, such as client satisfaction levels, transparency, timeliness and quality of financial and portfolio reporting, and meeting BoL regulatory and reporting requirements.

The various microfinance stakeholders interviewed agreed without exception that these three areas comprise the main support needs of microfinance institutions in Laos at present. This is consistent with other investigations, in particular the report into the “Training Needs and Delivery Strategy for the Microfinance Sector of Lao PDR” which stated that the microfinance “retail capacity in Laos has failed to develop” (page 1, own brackets) and that “the capacity building and training needs (of microfinance institutions) in Laos are widespread and acute” (page 1, own brackets).

Building the capacity of the microfinance sector in Laos will take time, and moreover cannot be attained through training alone. Internships, exposure visits, contact with experienced local and international experts, mentoring and other programs are required to confirm and entrench the necessary behavioral changes. Bluntly put, a two or three-year donor project is not going to enable significant improvements in microfinance institution performance: more time and efforts will be needed to achieve real improvements in the performance of MFIs.

For training and other institution building support to have an impact on the performance of microfinance institutions, a number of factors need to be in place. These include:

- an analysis of the capacity-building needs of the sector;
- an analysis of the providers of capacity-building and their services;
- a focus on meeting international best practice standards;
- ensuring follow-up to entrench behavioral change and related performance increases;
- ensuring a cadre of skilled and experienced trainers and technical advisors is in place; and
- ensuring there is relevant training materials and tools in the Lao language available.

Broader environmental factors that would strengthen the development of sector include:

- a burgeoning and growing private sector, with consistent support policies, laws and regulations in place;
- an appropriate regulatory regime (largely in place), with strong and consistent enforcement by a skilled and experienced supervisory unit;
- real commitment by the Lao government at all levels to the development of a vibrant microfinance sector;
- the ability for foreign entities to make equity investments in Lao MFIs
- general agreement among the key stakeholders on building a group of sustainable microfinance institutions. International donor agencies have been the primary funders and supporters of microfinance in Laos to date, yet have still to develop a shared vision for the microfinance sector with the government, nor what indicators would illustrate progress towards such a vision[308]; and
- a commitment by international donor and lending agencies "to cooperate, to consult, to be transparent, and to cease perpetuating bad practices, especially those implemented by certain government agencies"[309].

While there is apparent agreement among stakeholders as to the nature and type of support required there is however less clarity – and hence no agreement as yet – by microfinance stakeholders on *how* such support should be provided. This appears in part to have resulted from limited exposure to meso-level (or "wholesale") microfinance support providers, including limited understanding or experiences in the role of apex microfinance institutions. An underlying complication here is the high level of donor dependence, coupled with some poor donor practices in the microfinance sector: this led to a number of microfinance stakeholders for example suggesting that donors should lead and cover the expenses for all three areas of microfinance support using a short-term project-based approach. Interestingly it appeared that none of the individuals or organizations interviewed had considered

[308] The Lao Microfinance Working Group (or MFWG) has led a number of relevant regional workshops in an attempt to secure such a common vision and a commitment to best practises
[309] Ibid, page 2

the establishment of a dedicated institution aimed at providing funding and perhaps other support on an open-ended basis.

4. APEX INSTITUTION VS OTHER OPTIONS

The review of various reports together with the in-country interviews elicited a range of suggestions on how to meet the funding and other support needs of the microfinance sector in Laos. These can be summarized into four groups in order of response recognition as follows:-

a. Microfinance support projects – often referred to as "donor project(s) like CMP".
b. Providing support through existing institutions (i.e. rather than establishing a new institution), focused on:
    - loan finance from commercial banks, probably with support from a loan guarantee mechanism;
    - training support from one or more agencies, centered on the BoL Banking Institute; and
    - technical assistance from existing agencies, comprising government, private companies such as the Microfinance Centre (MFC), and NGOs
c. Microfinance association, with microfinance institutions (and possibly also service providers to the sector such as accountants, trainers, donors, and banks) as members
d. Apex microfinance institution

Each of options a. through d. are considered in turn, before turning to recommendations and next steps.

4.1. Microfinance support "donor" projects

This option was suggested by most of those interviewed as the preferred approach to providing funding and other support to the sector, and a number of reasons were mentioned for this, including (in no particular order):-

- Design of the projects can be targeted to meet specific identified needs;
- Transparent procurement processes, ensuring the "best" or most appropriate provider(s) are sourced;
- Projects define and limit resources given they are time and scope bound, and it may well then be easier to get donor support;
- "Donor" projects are well resourced, and offer significant opportunities to grow local expertise;
- Practitioners with extensive international best practice experience can provide inputs through "donor" projects who could generally not be afforded elsewhere, such as by MFIs themselves;
- With a given time span foreign experts would necessarily have an exit strategy, hopefully leaving local project members to add value to the sector thereafter;
- Projects may be more independent and able to better avoid political intrusion, and to therefore better enforce compliance with approved eligibility, reporting and other criteria.

It needs to be acknowledged that "donor" projects, in part reflected by the recent experiences of such projects in the Lao PDR, have:

- In a number of instances had limited consultation with local agencies, Lao government, or with other donors;

- Coordination of sector support efforts has been poorly coordinated, leading for example to duplication in resource utilization and opportunity costs;
- Supported projects (and projects with a microfinance component) that have not pursued best practice, even when the relevant donor agency has stated it is committed to such best practice standards;
- A lack of support for the institutionalization of microfinance sector support, for example with projects not having (or with limited or unrealistic) exit strategies;
- Donor transparency has been weak, and at times this has been compounded by limited accountability to local stakeholders.

Overall it is clear that donor supported projects have had - and will continue to have – a key role in growing the microfinance sector in Laos. There are however areas of improvement that donors and other stakeholders need to agree on before the impacts of support can be maximized.

4.2. Delivering support through existing institutions

A number of stakeholders indicated a desire to work through existing agencies rather than establishing new ones. Examples include:

- *loan finance from commercial banks and other wholesale funding agencies* (e.g. international social lenders to the microfinance sector such as the Dexia Fund managed by Blue Orchard[310]), probably with support from a loan guarantee mechanism. This would support a gradual move over time away from grant funding for the reasons outlined earlier. It should be noted that the nature of MFI balance sheets in Laos and elsewhere, with the bulk of assets comprising uncollateralized micro-loans and cash for working capital, often means even sustainable MFIs have challenges in meeting the traditional collateral requirements of commercial and other wholesale lenders. The feedback from stakeholders, the experiences by MFWG and CMP to date, including the CMP team's experiences in finding microfinance institutions that meet the undemanding eligibility criteria to receive grant funding (see Annex D), it is our opinion that even the most adventurous[311] apex institution will find negligible demand for wholesale loan funding amongst microfinance institutions. There will even be a limited demand for grant funding within any appropriate eligibility framework. The market for support from commercial and quasi-commercial sources will be concomitantly reduced, and is currently seen as negligible.
- *training support from one or more agencies*, possibly centered on the BoL Banking Institute, as well as from the one or two private agencies that focus on microfinance (e.g. Microfinance Centre). The Banking Institute has indicated a willingness to develop its microfinance training capacity and curricula, possibly as part of its core two year banking training program. Overall support for the development of a range of training agencies and individuals will help to promote a vibrant and better performing sector, and using existing agencies is likely to offer cost savings in comparison to the investment in any new apex institution. Moreover a new institution is likely to reduce the demand for training and other services at the Banking Institute and the other agencies, and it could be argued that it may even be counter-productive in this regard. Given that the costs for training support in practice has been primarily donor driven, with the head of the MFC estimating that

[310] See http://www.blueorchard.com as an example of such funds
[311] In terms of risk horizon lending criteria

90% or more of training costs have to date been covered by donors directly or indirectly, providing such support through an apex institution may simply lead to a shift of donor support from one vehicle to another. A mitigating strategy could be for any new apex institution to make use of these training providers, but of course this may simply increase delivery costs with little value add. Furthermore until the number and scale of MFIs in Laos has grown the market for these services will remain small.

- *technical assistance from existing agencies, including government, private companies, and NGOs.* The technical assistance needs of microfinance institutions are widespread, and include microfinance-specific auditing, MIS, HR, accounting, legal, and IT support. Many of the issues that apply to training (discussed above) are also relevant to technical assistance. While few in number and limited in capacity, there is some potential for existing agencies in these areas to provide technical assistance to microfinance institutions. An apex institution could bring a level of experience and technical assistance support that is not available in existing institutions, but this may be at the risk of these agencies being pushed out of the small microfinance institution support market. So such expertise may be better utilised in building the capacity of existing service providers to provide technical assistance to microfinance institutions.

While existing and new microfinance support agencies should be promoted and developed for the microfinance sector to flourish, this does not necessarily preclude support for an apex microfinance institution. In principle there could indeed be symbiosis between differing training and TA service providers, assuming a clear vision for the sector by all stakeholders and coordination between donor and other agencies if competition for scare resources is to be managed appropriately. The two main issues here currently are seen as being (a) that current support agencies have limited resources and already rely on donor funding, and (b) that the microfinance sector is small, with a limited market for training and TA support in terms of width (there is of course certainly a huge need for in depth support).

4.3. Microfinance association

Several stakeholders indicated a desire to establish a microfinance association with microfinance institutions (and possibly also service providers to the sector such as accountants, trainers, donors, and banks) as members, could conceivably provide a combination of funding, training and TA support to the sector. Our opinion is that this is not a practical option (with the possible exemption of generic training) in that for a membership body to hold its own members accountable to selection and eligibility criteria, to agreed best practice standards, and ensuring reporting and monitoring, is likely to raise conflict of interest issues. Moreover quality control is often difficult to manage for many membership organizations, even when generic third-party accredited training courses are undertaken such as those endorsed by CGAP. Conflict of interest issues are especially likely to arise in allocating funding to member MFIs. This option is accordingly not one that should be pursued in providing the generally understood services that would be offered by an apex microfinance institution. It should be stated however that support for a membership association does offer a number of benefits and funding and other support in principle is to be encouraged should the microfinance sector seek to establish such a body (this has not occurred to date).

4.4. An apex microfinance institution

There was very little understanding of an apex institution among stakeholders and how such an institution would operate. This is an option that has costs and benefits, advantages and disadvantages. During the in-country interviews it was clear that a number of the best practice requirements for the establishment of an Apex Institution as outlined earlier were not as yet in place. The main issues are as follows:-

- *Capacity and performance of existing microfinance institutions*: the number of microfinance institutions that will be able to meet even basic selection criteria is limited. The experiences of the CMP project in designing and managing a grant fund is ample evidence of this. The funding needed by the apex institution, and any related sustainability and social impact returns, must be based on a reasonable assessment of the number and scale of qualified MFIs that can take up the funding on offer. The current scale of even the largest microfinance institutions in Laos makes it impossible to warrant an apex wholesale funding institution. Establishing an apex institution may result in support being provided to microfinance institutions which do not meet the selection criteria. While providing funding, TA and training support in as small a market as that of Lao PDR will likely be most efficiently undertaken by one agency (given the clear economies of scale required to be cost-effective), this advantage does not out-weigh the related disadvantages.
- *Replicablility and lessons learned from elsewhere:* while there have been apex microfinance institutions established elsewhere (e.g. Sri Lanka, Nepal, Bangladesh) these experiences are not generally believed relevant for the Lao PDR, and so not all the lessons learned elsewhere are applicable.
- *Independence:* apex funding of MFIs must be based on clear selection criteria, such as portfolio quality, depth of outreach, management quality, and progress toward sustainability. The apex must have the authority to discontinue funding to MFIs that fail to meet these criteria. Political pressure can have serious adverse affects in determining who and how to support microfinance institutions, whether funding, training or in providing technical assistance. Apex microfinance institutions need to be politically independent, with a strong board able to protect the institution from political intervention. This is critical if the management is to make funding and other support decisions based solely on agreed selection criteria and related technical justifications. Government involvement in an apex microfinance institution can compromise its mission by inducing the apex to disburse funds or other support to unqualified microfinance institutions. This is likely to be a challenge in Laos where many microfinance institutions are owned in whole or in part by government at various levels - central, provincial and district.
- *Lack of a champion for the establishment of an apex microfinance institution:* a local apex institution may well be one of the more appropriate institutional options for entrenching support to the microfinance sector in the medium to long term (say after five years), but who would drive and lead the development of such an institution? This relates also to the independence issue. Even if there is agreement amongst stakeholders that a local apex institution is needed, there appears to be no local champion to support and carry through to implementation such a program. It is not believed the design and establishment of an apex institution would most appropriately be driven by donor(s) or other external stakeholders. In providing funding and other support independently this also infers that the BoL – given their supervisory and regulatory responsibilities – would have significant conflict of interest issues in implementing such a role. Certainly supporting such developments is important to BoL, but not selecting or directly providing funding, training, or TA. Given

their supervisory and other roles, the suggestion that the MFFMU[312] could serve or be transformed into an apex institution is not supportable. Overall an independent agency(s) is likely to be better placed to assess risk and allocate funding without favor to the microfinance institutions targeted.

- *Assisting microfinance institutions to access commercial funding:* the three commercial banks interviewed indicated that they were not considering lending to microfinance institutions, in part as very few MFIs have a track record of profitability, were unable to provide necessary collateral, and the microfinance market was too small to develop a targeted product. These commercial banks did indicate they would consider lending to microfinance institutions should a significant level of guarantee be provided.
- *Apex management:* the management needs to be of very high quality, possessing a blend of microfinance expertise, managerial and financial skills, and integrity. This will be a serious challenge given the brief track record of the sector, the lack of any best practice microfinance institutions to date, and the nascent nature of the microfinance sector in the Lao PDR. Simply put, there is at present a dearth of local experienced and competent microfinance practitioners that are in a position to effectively manage an apex microfinance institution.

As to which is the most appropriate institution to provide funding and other support to the microfinance sector in Laos, these are not mutually exclusive, and a variety of institutional and project approaches is considered appropriate over time.

There is no current ability for a microfinance support institution to be viable without donor support in the short to medium term. In the long term (five years plus) there is potential for an independent apex microfinance institution to provide such support. It is clear that donor support to the microfinance sector, especially to microfinance institutions, will be needed for the next five years at a minimum.

5. CONCLUSIONS AND RECOMMENDATIONS

The development needs of the Lao microfinance sector remain many and varied. Despite the emergence of many new institutions in recent years (28 registered MFIs as at December 2009), management and governance competence levels remain low. Very few, if any, MFIs meet international best practice performance standards or would currently be eligible for debt funding. Market penetration is gradually expanding but remains very low. The issuance of comprehensive, revised regulations by BoL in 2008 has strengthened BoL's role and its supervisory capacity has increased significantly in accordance with its increased responsibilities, but its capacity building needs remain great. Basic meso-level infrastructure exists in the form of a few training organizations, one MIS agent, a couple of auditors, and a barely functioning microfinance working group – this level is in need of strengthening and support.

In recent years a number of donors have stepped up their microfinance activities in Laos, including Gtz, German Savings Bank, DGRV, Lux Development, CARD and a range of international NGOs. UNCDF has also been investigating options for involvement, while World Bank and others continue to fund the establishment of village development funds. There is need for greater harmonisation of donor effort,

[312] MFFMU, or Microfinance Fund Management Unit, is the BoL team responsible for managing and implementing the CMP Microfinance grant program.

improved understanding of and adherence to good donor practices, and for the range of in-country stakeholders to act in a more coordinated manner.

5.1. Options and recommendations for APEX functions and the MFFMU

It is beyond the scope of this review to assess all support needs of the MF sector and the various options for addressing these. The focus here is on the potential functions performed by an APEX agency (i.e. provision of debt and/or grant financing and TA to MFIs) and on the future of the MFFMU.

The following are considered the main options for delivering the functions commensurate with an APEX institution (i.e. financial and technical support to eligible MFIs) and for the MFFMU.

Option A: Establish an APEX agency with an initial focus on training and capacity building through provision of grants, and gradually increasing debt funding role

This would require the establishment of new agency independent of BoL. It would be inappropriate for the apex to be controlled or managed by BoL given the many potential conflict of interest issues that would arise. Certainly BoL and the Government of the Lao PDR have a critical role to play in any apex microfinance institution, but not in any controlling role. Given the low short to medium-term demand for debt, the emphasis would initially need to be on training, capacity building and awarding of grants to MFIs. Over time, as demand and eligibility for debt increases, lending activities could increase.

The main benefits and advantages of this option include:

- ✓ Provides a soft entry into the provision of debt, and will ultimately provide MFIs with a local source of accessible debt
- ✓ Enables independence of agency from existing government and MFI stakeholders
- ✓ Enables a combination of grants, debt, training and TA to MFIs
- ✓ Provides a long-term source of finance and TA to MFIs

There are however a number of risks and challenges with this option, including:

- Even medium-term demand for wholesale debt is projected to be low, and may not enable the apex to reach sufficient scale to be effective and viable. Such an agency would likely be heavily donor dependent for at least 5 years, and probably longer.
- There appears to be little government or other stakeholder support for such an option
- There is no obvious institutional home for such an apex
- Acting and being seen as a grant provider may undermine the ability to engage in effective lending
- The MFFMU is part of BoL and would not be able to be transferred to an independent entity to form the basis of an apex.
- The rationale for establishment of new national apex lending agencies is questionable; it may be more effective and efficient to support MFIs to access existing domestic and international lenders
- If the agency does not engage in lending, or is not able to do so viably, then there is little justification for its establishment. Grants, training and technical assistance can be delivered through existing mechanisms.

On balance, the disadvantages, risks and challenges of this option outweigh the benefits and advantages.

Recommendation 1: The establishment of a microfinance apex institution is not recommended at this time.

If option A is not pursued then the direct provision of debt financing can effectively be ruled out in the short-term.

Recommendation 2: A review should be undertaken in approximately 2-3 years' time to re-assess the need and demand for a microfinance apex institution. An independent local champion for an apex institution is needed and must be identified prior to any institutional implementation.

Option B: Strengthen training capacity of other existing training institution(s)

The core needs of the sector remain quality training and technical assistance to strengthen management capacity of MFIs, and development of meso-level infrastructure. These two needs could be met by partnering with an agency (or agencies) to strengthen capacity to deliver quality training and technical assistance to the sector. This may involve:

- ➢ Building the human resource capacity of the partner agency
- ➢ Developing comprehensive training programs and certification of trainers and trainees
- ➢ Arranging international exchanges and MFI internships
- ➢ Potential provision of onsite technical support to MFIs

Examples of potential institutional partners are the BoL Banking Institute, a university or private sector training agencies.

The main benefits and advantages of this option include:

- ✓ Meets the core need of the sector: to build human capacity and skills
- ✓ Is focused and targeted
- ✓ Has been done successfully by ADB elsewhere (e.g. with the Institute of Banking and Business Management in PNG)
- ✓ Builds existing actors and meso-level infrastructure, thereby avoiding unnecessary replication or risky start-ups

The main disadvantages, risks and challenges with this option include:

- No strong partnership contenders. BoL Banking Institute has introduced some basic microfinance elements into its training and has indicated a willingness to discuss options, but it currently has a focus on training public sector banking staff and has not yet indicated a strong desire to make microfinance training a significant function. Its ability to provide dynamic, demand-led training would need to be investigated.
- May not be necessary given new initiatives in this area by MFC, CARD and the German Savings Bank.
- The microfinance sector is small and demand will be limited. Cost recovery will always be a challenge.
- Does not make use of the existing MFFMU staff capacity and working relationship
- Limits ability to meet broader sector needs, and fails to build on ADB successes and experience in strengthening policy and regulation

The lack of a strong partnership contender, combined with the limited prospects for building on ADB's close working relationship with the microfinance unit in BoL, are perhaps the main weakness of this approach. If a suitable partner agency were to emerge then this option may warrant further consideration.

Recommendation 3: A partnership to strengthen the training capacity of an existing training institution(s) is a potential option that warrants further investigation

Option C: Continue broad project-based sector support in partnership with BoL/MFFMU

This option would involve a continuation of the partnership with BoL/MFFMU, either through a second phase to the CMP project or a new project. It is recommended that the emphasis of such a project shift slightly to enable broad-ranging programmatic support to be focused on the macro and meso levels, and potentially the micro level. A range of potential areas of project support are outlined below:

Macro-level: Policy & regulation

- Strengthen BoL microfinance unit and support upgrade to department level – through training and mentoring in technical microfinance areas as well as human resources and management skills
- Support ongoing revisions to microfinance regulations and related policies (such as foreign investment, local registration of MFIs, and village funds) – through information sharing, workshops and technical assistance
- Investigate opportunities for integration of microfinance into broader financial systems (including insurance) – through research and advocacy
- Investigate opportunities for expansion of mobile and other e-banking mechanisms to expand outreach to remote communities – through research and advocacy

Meso-level: Financial infrastructure

- Strengthen the capacity of existing training and technical assistance providers – through adaptation, translation and dissemination of a range of training materials; support trainers to become certified
- Strengthen accounting and audit services – through development and promotion of industry standards, training and certification
- Strengthen MIS capacity – by supporting development of improved Lao language MIS applications, and a range of service providers
- Support the microfinance working group and assist in the development of a microfinance association (if stakeholders choose to pursue this option) – through strategic planning, exposure visits, and support to the secretariat; development of good practice guidelines; funding of research and sector studies in topical areas
- Support the development of models that enable MFI clients to access complementary training and support services – such as literacy and numeracy training; income generation and small business development support and improved access to markets.

Micro-level: Financial intermediaries

- Support MFIs to access training and technical assistance – through matching funding for board and staff training activities, including formal training, internships, exposure visits, and on-site technical assistance
- Support MFIs to access commercial and quasi commercial debt – through introductions to lending agencies, assistance in preparing for application, assessment and reporting; potential provision of loan guarantees

- ➢ Support MFI clients to access complementary training and support services – through partial subsidy of access to services

The main benefits and advantages of this option include:

- ✓ Meets a wide range of sector needs at various levels, and enables flexibility based on needs and successes
- ✓ Builds on effective working relationship with BoL microfinance unit / MFFMU and past experience and successes
- ✓ Enables relatively quick start to activities by building on existing processes, structures and resources
- ✓ Engages BoL at an appropriate level and strengthens its general microfinance role and capacity
- ✓ Builds existing actors and meso-level infrastructure, thereby avoiding unnecessary replication or risky start-ups
- ✓ Avoids creating a long-term liability (such as an apex or training institution would)
- ✓ Enables apex and other options to be revisited at a later time (without premature commitment)
- ✓ Has strong support of BoL and is its preferred option (refer BoL comments on draft report)

The main disadvantages, risks and challenges with this option include:

- Strong reliance on cooperation and capacity of BoL
- A broad range of activities may lead to lack of focus
- Achievement of tangible results will take time

This is considered the only option for the MFFMU looking forward. If this option is not pursued then the MFFMU ceases to have a function and staff would likely resume normal duties in the BoL microfinance unit.

On balance this is considered the most appropriate option moving forward. The strengths and advantages heavily outweigh the disadvantages

Recommendation 4: Continue broad project-based sector support in partnership with BoL/MFFMU through a new phase or follow-on project to CMP

Regardless of which option (if any) is pursued, it is important that this be considered and planned in close consultation with other donors and domestic stakeholders. Any of these options could potentially be undertaken in partnership with one or more other donor agencies.

Recommendation 5: Consult with a wide range of sector stakeholders, consider collaboration with other donor agencies, and ensure ongoing coordination of activities during implementation.

Annex C. FISD Training Needs Assessment and Evaluation of Study Tours

Report on Capacity Building Efforts on and Training Needs of the Financial Institution Supervision Department of the Bank of Lao PDR

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

Prepared for the Asian Development Bank, Southeast Asia Department

Timo H. Hogenhout, 2012

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Abbreviations and acronyms

ADB	Asian Development Bank
AFP	Access to Finance for the Poor (GIZ program, supports FISD)
BOL	Bank of the Lao PDR
BSD	Bank Supervision Department (of BOL)
CMP	Catalyzing Microfinance for the Poor (ADB project, worked with MFId)
DT MFI	Deposit Taking MFI
FISD	Financial Institution Supervision Department
GIZ	Gesellschaft für Internationale Zusammenarbeit (German organization for international cooperation)
Lao PDR	Lao People's Democratic Republic
LPFI	Lao Postal service Financial Institution
MAFIPP	Making Access to Finance more Inclusive for Poor People (UNCDF program, works with FISD and BOL)
MF	Microfinance
MFI	Microfinance Institution
MFId	Microfinance Institution Division (former BOL division)
NBFI	Non Bank, non insurance Financial Institution
NDT MFI	Non-Deposit Taking MFI
Q&A	Questions and Answers
RFSDP	Rural Finance Sector Development Program (ADB program)
RMF	Rural and Microfinance
TA	Technical Assistance
UNCDF	United Nations Capital Development Fund
VMLF	Village Managed Loan Fund
VSLF	Village Saving and Loan Fund

Capacity Building Efforts and Training Needs
Bank of Lao PDR's Financial Institution Supervision Department

I. INTRODUCTION

1. This report on the capacity building efforts and the need for training of the Financial Institution Department (FISD) of the Bank of Lao PDR (BOL) has been made as part of a set of activities under Component 2 of Asian Development Bank's (ADB) Technical Assistance (TA) 7500-LAO. Component 2 of TA-7500 was set up to deal with issues regarding the Rural and Microfinance sector (RMF). This report is the third and final report under Component 2, following an Inception Report and an Assessment of the Rural and Microfinance Sector, apart from four reports evaluating study visits that have been organized as part of the activities under Component 2.[313]

2. During the inception period ADB and the government agreed to prioritize the activities under Component 2 of TA-7500. The need to prioritize was identified following the recent launch of two projects to assist the FISD, by donors GIZ and the United Nation Capital Development Fund (UNCDF). The prioritization aimed for the three donor institutions to complement activities in order to maximize the effectiveness of the projects as a whole and of each of the projects individually.

3. ADB and the government agreed to prioritize Component 2's activities by focusing on four deliverables: a rural and microfinance sector assessment; the design and implementation of four study visits; an assessment of the capacity building needs of the FISD; and a stakeholder workshop.[314] This report in hand contains an overall evaluation of the study visits and of the FISD's needs for capacity building.

4. The report has been based on interviews, on documents pertaining to the FISD's responsibilities and on available documentation on capacity assessment and training activities as part other overlapping projects delivering assistance support to the FISD.[315] Interviews were held with all staff of the FISD, divided into four groups that were based on the FISD's functional organization in four divisions; with the senior staff members that have participated in study tours prior to leaving in order to identify learning objectives and afterwards in order to evaluate the study tours; and on interviews with consultants and staff of ADB's "Catalyzing Microfinance for the Poor" project (CMP), GIZ's "Access to Finance for the Poor" project (AFP) and UNCDF's "Making Access to Finance more Inclusive for Poor People" project (MAFIPP).[316]

[313] The Evaluation Reports of the four study visits have been added as Appendices to this report in hand.
[314] Source: the Aid Memoire concluding the ADB inception mission for Component 2 of TA 7500, fielded from 4-7 October 2010.
[315] Interview with the management of the FISD for the purpose of assessing capacity building needs were not able to be held.
[316] This report supposes the reader to be familiar with the content of the Assessment of the Rural and Microfinance sector of the Lao PDR that has been made as part of the activities under Component 2 of TA 7500. Parts of it however have been included here if and where of direct importance for the subject of this report in hand.

5. Following introduction this report elaborates on the FISD, its responsibilities and its position in the RMF spectrum in Chapter II; reports on Training Needs of the FISD in Chapter III and concludes with the objectives and outcomes of the made study tours in Chapter IV.

II. THE FISD and its RESPONSIBILITIES

6. **The FISD and RMF Supervision.** Since Component 2 of TA-7500 was set-up specifically for the purpose of dealing with RMF sector related issues it is important to clarify the FISD position in the context of overall RMF supervision. RMF provision involves a broad range on organizations including banks, pawn shops, the Lao Postal Service Financial Institution (LPFI), semi-formal village-managed loan funds (VMLFs), in the future possibly telecommunication providers and both social and private insurance providers.[317] Supervision of RMF service delivery is a broader issue than supervision of formal MFIs only.

7. **Regulation and supervision.** Regulation and supervision of the various types RMF providers is spread out over a range of different parts of the government.

Table 1: Supervision oversight matrix

Financial Service Providers by type	Responsible Government Agency for Supervision
1. Provision by Banks	Banking Supervision Department of Bank of Lao PDR
2. Provision by non-bank, non-insurance formal financial service providers	Financial Institution Supervision Department of Bank of Lao PDR
3. Provision by semi-formal "village-managed loan funds"	- Various government organizations (Ministry of Planning and Investment, Ministry of Agriculture and Forestry, National Leading Committee on Rural Development and Poverty Eradication at the Prime Minister's Office) at all levels - Various mass organizations (Lao Women's Union, Lao Front for National Construction) at all levels - The Financial Institution Supervision Department of BOL is the responsible financial sector authority.
4. Provision by commercial insurance companies	Fiscal Policy Department of the Ministry of Finance[318]
5. Provision through Social Security Organization	Ministry of Labor and Social Welfare
6. Provision through Community Based Health Insurance Schemes	Ministry of Health

[317] See for more background the Assessment of the Rural and Microfinance sector of the Lao PDR made under this Component 2.

[318] The Ministry of Public Security is responsible for one insurance company in which it holds a stake according to the Prime Minister "Decree on the Financial Institution Development Strategy of the Lao PDR 2009-2020" (No. 273/PM, 22/09/2009) and BOL's Financial Sector Strategy of 2008. However, according to the MOF only the Fiscal Policy Department of MOF is responsible.

8. **RMF supervision in BOL.**[319] Since banks dominate the formal financial sector overall and play an important role in RMF delivery in terms of the number of customers, the managed amount of savings and the number of payments handled, within BOL banks should take priority in planning of supervision resources. Support to the RMF supervisory capacity of BOL should include supervision of banks involved in RMF service delivery and should involve BOL's BSD. Illustrating the importance of an overall concept of supervision of microfinance activities, only last year has the Microfinance Workstream of the Basel Committee issued guidelines on Banking Supervision called "Microfinance activities and the Core Principles for Effective Banking Supervision", which relate to both bank and non-bank providers. [320] [321] [322]

9. **NBFIs' importance and role in RMF.** The combined group of Non-Bank Financial Institutions (NBFIs) and insurance companies has traditionally played a minor role in formal financial service delivery, indicated by the fact that the combined group owns a mere 2% of all assets in the financial sector. Still as can be seen in table 2 following below paragraph 9, since 2007 rapid growth has taken place in the number of non-bank providers and in the number of outlets.

10. **NBFIs relative importance.** Having mentioned the relevance of supervision of banks delivering RMF services, it should be stressed that a too conclusive statement on supervisory priority can not be made. This is partly the case because the relative significance of supervision of NBFIs can not be fully assessed due to lack of information on the current scale and scope of their activities. More so even this is the case because of NBFIs' potential for growth as main RMF suppliers and the possible inclusion of a main group of semi-formal providers, the so-called Village Savings and Loan Funds (VSLFs) in the formal sector. With increasing demand put on BOL's capacity as a consequence of the growth in number, variety and complexity of financial sector providers and their activities, it is essential for both BOL overall as for the FISD to prioritize, focus and plan supervisory efforts based on an assessment of the risks for the overall soundness of the financial system posed by each (type of) provider and based on considerations related to protection of low-income households.

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[319] In this report we forego the issue of insurance supervision with regard to RMF, as it is outside the scope of TA 7500.

[320] The Basel Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central bank Governors of a group of ten countries in 1975. It currently consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Basel Committee provides a forum for regular cooperation on banking supervisory matters with the objective to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

[321] "Microfinance activities and the Core Principles for Effective Banking Supervision", Basel Committee on Banking Supervision August 2010, Bank for International Settlements.

[322] This report only sees to supervision by the FISD as successor of the MFId and will not elaborate in detail on supervision of microfinance activities by banks. Supervision of banks has been dealt with under TA 7500's Component 1.

Table 2: Non-bank, non-insurance financial service providers and outlets over 2003-2010

Financial service providers (year-end)	**2003**	**2006**	**2007**	**2008**	**2009**	**2010** [323]
Number of Non Bank Financial Institutions						
Licensed Pawn shops	2	13	14	15	21	23[324]
Licensed Leasing Companies	na	na	na	na	5	4
Companies licensed to transfer money[325]	na	na	na	na	na	7
Total number of agents for international money transfer companies[326]	na	na	na	na	na	18
Total number of Foreign exchange outlets	na	na	na	na	na	365
Lao Postal Financial Institution[327]	1	1	1	1	1	1
Licensed Deposit Taking MFIs[328]	0	1	2	2	4	8
Licensed Saving & Credit Union[329]	2	8	8	12	14	14
Licensed Funds	0	2	2	2	2	2
Source: BOL						

11. **NBFIs and the FISD**. BOL's FISD's main responsibility is regulation and supervision of non-bank, non-insurance financial service providers (or NBFIs). The FISD and a Bank Supervision Department have both been split of previously existing Bank and Financial Institution Supervision Department in August 2010, in order to deal with the increased supervisory demand made on BOL. The FISD is responsible for a range of different institutions; compared to the Microfinance Institution division (MFId), FISD's predecessor, its responsibilities have increased and become more complex.[330] An overview is given immediately below.

12. **FISD's added supervisory responsibilities since August 2010**.[331]
The FISD has been given added regulatory and supervisory tasks compared to its predecessor, the MFId;

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[323] 30 June 2010
[324] The number of pawn shops has earlier been 28; dissolved pawn shops have not been included.
[325] Companies other than banks
[326] Including banks
[327] The Lao Postal Financial Institution has 18 branch offices and some 135 postal outlets
[328] Within the group of 22 licensed MFIs, 10 separate branch offices have been established; one branch has received a separate license but has been consolidated with its head office in table 2.
[329] Including SCUs in BOL and Enterprise of Telecommunications Lao
[330] See Appendix 3 for the organizational chart before 27 August 2010, Appendix 4 for the current position of BSD and FISD in BOL and Appendix 5 for the organizational structure of the FISD.
[331] Looking at the FISD's portfolio of responsibilities, three organizations are out of place; the Depositor Protection Fund, the Debt Processing Centre and the Lao Central Payment Network. All three organizations do not directly provide financial services to the public, are outside of the scope and level of technical expertise of the FISD, represent assets or (potentially large) liabilities of the State and represent an interest of the same organization of which the FISD is a department; BOL. Auditing these organizations is beyond the capacities of the FISD, and seems beyond its normal jurisdiction and scope of work. A role of the State Audit Organization and possibly of the Ministry of Finance should be considered.

vii. **Leasing Sector**: five licensed companies, two license requests in the pipeline;
viii. **Non-Financial Companies** (mainly involved in trading) that have received an agency of money- transfer organizations such as Western Union or Money Gram: four companies;
ix. **Telecommunication providers:** The telecommunication service provider "Lao Telecom", a joint venture between the Lao government and a Thai telecommunication company, has been licensed to provide and facilitate money transfers under the name "Mobile Money";
x. **Lao Central Payment Network**: a joint venture between BOL and private investors aimed to build a system that facilitates cashless payments using debit and credit cards;
xi. **Debt Processing Centre of BOL**: a department of BOL that buys portfolios of loans with repayment difficulties from SOCBs and aims to consequently collect the loans;
xii. **Depositor Protection Fund**: organization that is set up to insure deposits; it is part of the organizational structure of BOL yet formally independent.

13. **Supervisory responsibilities the FISD has taken over from the MFId**

vii. **Pawn Shops**: licensed (23 companies);
viii. **LPFI**: licensed
ix. **Funds**: licensed (2 funds);
x. **Deposit Taking MFIs (DT MFIs)**: licensed (8 DT MFIs);
xi. **Savings and Credit Unions (SCUs)**: licensed (12 SCUs);
xii. The FISD has received 10 registration forms, balance sheets and income statements sent by Non-Deposit Taking MFIs.

14. **FISD, MFId, NBFIs, MFIs and RMF**. The MFId, despite the fact that its name suggested otherwise, has always been responsible for regulation and supervision of more than microfinance institutions (MFIs) only.[332] The name of it successor, the FISD, has made this distinction clearer and has had types of institutions added to its portfolio with activities outside RMF service delivery. As Component 2 sees too RMF only, assessment of capacity building and training needs of the FISD will be specific only with regard to RMF providers. However, the more general, overall elements of the FISD's training needs assessment (TNA) will be relevant for all of its objects of supervision.

15. **FISD's responsibility for MF development**. Based on the explicit instruction of the government in the form of a Prime Minister Decree, BOL has been made responsible for MF development in the Lao PDR.[333] In order to achieve *"strong and dynamic growth"* of MF service delivery, BOL shall *"conduct research and issue the regulations to ensure the supervision and promotion of microfinance*". With the FISD playing an important role within BOL with regard to MF, the PMO instruction carries important consequences for the FISD's portfolio of responsibilities.

[332] The types of institutions it was responsible for were all however involved in some form of RMF delivery.
[333] No. 05/PMO, 4 April 2007.

III. FISD CAPACITY BUILDING NEEDS ANALYSIS

16. **Capacity building and TNA**. During inception it was agreed by the government and ADB that, in order to assess capacity building needs of the FISD, a TNA will be done through a gap analysis to all trainings provided by donors, which will be the aim of this section.[334] [335] As TA 7500 Component 2 has been designated to deal with RMF related issues only, following a more general assessment of the FISD and its capacity building needs details will relate to providers engaged in RMF only.

17. **Supervision objectives**. Key objectives of supervision are preventing behavior by financial service providers that would negatively affect confidence in the financial system, financial sector stability or the rightful interests of consumers, or that would constitute a financial crime. Supervisory activities should be expected to achieve that goal at a cost that weighs-up against the benefits if they are to support building a sound and stable financial sector, create trust and protect consumers. In terms of the FISD, if supervision of certain types NBFIs would be beyond FISD's capacity now and in the mid-term future, institutions should not be licensed. The distinction should be made explicit and publicly known, at the risk of undermining trust in the financial system and in BOL's authority.

18. **Current situation FISD supervision**. The NBFIs under FISD's supervision have all been licensed however have not all been (actively) supervised. The portfolio of NBFIs under FISD supervision has significantly been extended only in August 2010 when compared to their predecessor (the MFId) and the supervisory framework is not fully in place for all types of NBFIs. Oversight over the scale and scope of the activities of the overall group of NBFIs and the scale of risk involved is lacking, just as solid understanding of the objectives of supervision related to and types of risks involved in the activities of most types of NBFIs.

19. **Need for supervision strategy and planning.** In order to be able to prioritize and plan supervisory activities as well as the consequential development needs, a supervision strategy should be developed assisted by a financial sector supervision specialist and based on an adequate sector assessment. In as far as MF provision is concerned the strategy should build on recently issued "Guidelines on Microfinance activities and the Core Principles for Effective Banking Supervision" by the Basel Committee on Banking Supervision yet should be embedded in the specific setting of the Lao PDR. The strategy should map FISD's portfolio of responsibilities in terms of the scale and types of risk, and in terms of the various key objectives of supervision, both prudential and non-prudential. Before finalization and implementation of the strategy, it should be assured there is full understanding of key supervisory objectives and risks related to the different types of NBFIs within management and (senior) staff

[334] Aid Memoire concluding the ADB inception mission for Component 2 of TA 7500, fielded from 4-7 October 2010 and Inception Report.
[335] The organizations mentioned in footnote no. 19 will remain outside the cope of this assessment.

of the FISD. The resulting development needs should be put on a timeline, including a definition of milestones and expected outcomes.

20. **Ownership FISD management**. The development of the strategy should be done with full ownership of the FISD management, whose active participation and leadership are crucial, and who should be responsible for both the development and implementation of the strategy. The planning of responsibilities, activities and needed resources should be done at the level of the four divisions as well as overall and should include the BOL branches. Senior staff should be actively involved in planning activities.

21. **Human resources**. RMF sector development and supervision are highly human-capital intensive, and in effect make human capacity development of central importance. From the FISD supervisory strategy mentioned in the previous paragraph normally a planning of the required competencies and necessary number of staff should follow. The required competencies should be assessed, described and related to explicit, detailed job descriptions. Recruitment and selection should be based on the FISD's required competencies. The competencies should be determined based on the on the ability of fulfilling the tasks and responsibilities embedded in the job descriptions, and should be related to (available) training and development programs. In building a structure of job descriptions, both the jobs and the seniority within the job should be graded in various levels, with additional remuneration or secondary rewards attached to reaching a higher level. Based on job descriptions and agreed upon targets and acquired competencies, performance should be regularly and systematically evaluated based on objective criteria related to performance in an objective, verifiable manner.

22. **Human Resource Development in policy documents**. BOL has made improvements in Human Resource Development over the last five years and the traditional system of rotating staff has been moderated. Human Resource Development as a main priority has been targeted both in the 7th National Socio-Economic Development Plan (2011-2015) and the Financial Institution Development Strategy (2010-2020).

23. **Contract and code of conduct**. As required by Law, the elements of the working relationship between BOL and its staff mentioned in paragraph 20 must be codified and made explicit in an employment contract.[336] Codifying the employment relation in an explicit labor contract serves another important purpose. BOL and the FISD have a specific, important position with due responsibility for building a reliable financial sector and protecting its customers. BOL interventions can have significant consequences for financial service providers and their customers, and enforcement or lack of it could potentially or at least theoretically lead to liability. To be able to do supervisory work without obstruction, supervisors should be protected from liability based on their supervisory work, which should be made explicit in their employment contract and backed up by Law. The importance of the position of BOL as financial regulator and supervisor also brings with it the need for the public to be absolutely sure of the independence and objectivity of BOL and its staff. As customary for Central Banks, management and staff should sign a Code of Conduct aimed at

[336] Labor Law of the Lao PDR (06/NA, 27/12/2006), article 3.1

preventing conflicting interests, with explicitly described consequences for non-compliance.

24. **FISD's supervisors**. As a consequence of the modification of the system of staff rotation there now is a core-group consisting of a manager and some 14 staff with up to four years of experience with supervision of formal MFIs, a smaller group of which even up to seven years. Recently, in order to cope with the extended workload caused by an increase in the number and types of NBFIs under supervision, a total of 19 new freshly graduated staff and two new managers have been added, almost all of whom need to be trained from scratch. Simultaneously, the four BOL branches have taken over responsibility for supervisory tasks, adding the issues of coordination and organizational priority between head office and branch offices.

25. **Training and TA received**. Since the MFId's inception, its staff and management have been the recipients of ample, extensive training and TA related to a broad range of aspects of MFI regulation and supervision. Programs offering training and TA related to MFI regulation and supervision have been ADB's Rural Finance Sector Development Program (RFSDP; 2004-2010), ADB's CMP (2007-2011), GIZ's AFP (2009-present) and UNCDF's MAFIPP (2011-present). Regulatory and supervisory issues on which training and TA has been delivered under the programs mentioned include the design and implementation of adequate microfinance regulations; holding stakeholder workshops; basic accounting; MFI specific accounting; on-site supervision; off-site supervision; financial analysis related to MFIs; use of the MIS system most Lao MFIs apply; and an introduction to MFI risk management. Training has been focused on the MFIs that have been embedded in the Lao MF regulations. Training included the use of the existing, adequate MFI Supervision Manual and of the CAMEL-based analysis concept. As part of ADB's CMP program, a small group of FISD staff and management has been trained and assisted in setting-up and managing a microfinance fund, which can be used to fund proposals made by MFIs and monitor implementation on the basis of specifically defined program objectives. Details on recently received training and TA can be found in Appendix 8; on training and TA as part of ADB's CMP program in Appendix 9.

26. **Assessment of FISD training and TA**. The group of experienced members of the FISD staff has generally received ample, good quality training and TA related to MFI regulation and supervision. For the future, the choice of topics and the design of training programs should be steered to be more demand driven and should be based on adequate assessment of the needs of RMF sector as a whole and of the FISD in particular. Partly as a consequence of the overwhelmingly available donor support for microfinance development, the FISD has been overloaded with support aimed only at supervising and supporting a small group of formal MFIs with little outreach (and with support aimed at those MFIs for that matter). It is recommended to embed training and TA support in a broader setting of an overall supervision strategy and planning, with ownership and active involvement of the FISD management and senior staff, based on an adequate RMF sector assessment.[337] Furthermore, training and TA

[337] Ultimately the objectives and principles embedded in the "Policy Statement for the Development of a Sustainable Rural and Microfinance Sector" of the government (1760/PM, 17/12/2003) should be at the basis of support.

should be embedded in a broader HRD policy, with a focus on both management's and staff's capacity to fulfill the roles and handle the tasks detailed in their respective job descriptions.

27. **FISD training needs.** Still existing needs of senior FISD staff relate to core issues such as understanding the objectives and purpose of supervision, the roles each of the divisions play and how the various divisions should communicate, coordinate and cooperate. Examples are questions on who should initiate or lead the supervisory process, who should address results of an inspection report and an off-site analysis, and which officer within an institution should be addressed, what consequences of made observations should be, when to enforce, how and by whom. Supervision can currently be considered compliance based and MFIs are predominantly treated in a similar way regardless of risks, size, strength of internal organizations and control, and financial strength. Some MFIs have been in operation for years without meeting prudential ratios and criteria embedded in the MF regulations. Secondly, there is a need for existing experienced staff for hands-on, on-the-job technical support or back-up, based on the need to deal with concrete questions and challenges in a real working situation.

28. **Training of new staff**; **class room, BOL in-house**. With the recent extension the financial sector and consequential increase of the number of staff a new element has been added to the need for training and TA; that of sustainability. BOL and the FISD can or should not be dependent on support by international development organizations for the future. The existing capacity within experienced staff should be shared with newly hired staff in a systematic and structured way. BOL should be assisted to design such structure, for which the department responsible for HRD should also be involved. Simultaneously, there should be intense training of new staff in class room setting. Training should partly be general (basic introductions in accounting, in the existing regulatory and supervisory framework, in institutions under supervision and related objectives of supervision) and partly focus on enabling an technical officer to deal with the tasks detailed in their specific job description, possibly first related to one type of institution only with different officers involved in supervising different institutions. After ample knowledge and experience has been gained by officers, they should be involved in teaching others. This way, in-depth knowledge and experience can be gained and disseminated more rapidly.

29. **Non-MFI RMF providers**. The FISD is responsible for developing an enabling setting that allows for RMF service delivery by a range of NBFIs other than formal MFI and for their supervision. The setting should be based on understanding of the unique position and added value in RMF delivery by each of the (types of) NBFI providers, on related supervision objectives and on an analysis of the supervisory priority of each of the NBFIs. From the perspectives of RMF development and supervision these RMF-services providing NBFIs could well take priority over MFIs in a number of cases. NBFIs referred to include pawn shops, the LPFI, telecommunication companies, leasing and finance companies in as far as they are involved in financing items such as household appliances or motorbikes and non-financial companies with a license to provide money transfers. No training or TA has so far been provided to the FISD in creating an enabling and supervisory framework for those types of providers. Assistance however is needed as in cases regulations are in need of development, as well as licensing procedures or criteria, charts of accounts,

supervision manuals and procedures, and reporting requirements. In as far as they are in place implementation should be effectuated. Currently, with flexible funding available for FISD capacity building measures in the UNCDF MAFIPP program and priority placed on extending mobile-phone based financial service delivery in both the MAFIPP (UNCDF) and AFP programs (GIZ) a first step in broadening the scope of TA and training to the FISD could well be made soon, depending on BOL's ownership.[338]

30. **TA to active coordination, exchange of knowledge and experience, and sector leadership**. RMF development and supervision require intense coordination and communication with industry and government stakeholders on various themes or topics central to successful RMF development and supervision. This requirement puts a strain on the FISD's management and senior staff and TA is well advised. Again in this case could flexible funding under MAFIPP and AFP deal with the requirement, again depending on BOL ownership.

31. **TA to develop a platform for communication with VSLFs and their instigators and develop a strategy for a financial cooperative sector.**[339] VSLFs are a main RMF service provider in the Lao PDR yet are currently not adequately encompassed or embedded in the MF regulatory setting. The FISD could be technically assisted to engage VSLFs and their government and mass organization's partners, with the objectives of developing a joint vision on VSLFs in RMF development and finding a mutually beneficial way to include VSLFs in the formal sector. The TA focus first on building mutual understanding and trust between BOL and the stakeholders involved with VSLFs. This requires openness on both sides, and the willingness to get to know and understand each others RMF principles, methodologies and interests. To enable this, a platform of communication and coordination should be created which should focus on finding a way forward for VSLFs that allows for the benefits of supervision and enables integration of VSLFs in the formal financial sector in a way that strengthens them and stimulates their development.

32. **TA and training by specialists**. The non-MFI NBFIs involved in RMF service delivery have specific features which warrant the need for the involvement of specialists in the particular type of provider to deliver the necessary TA and training. The same is true for the issue of development of a strategy for a strong financial cooperative sector.

[338] TA to supervision of Lao Telecom by the FISD would have been urgent if Lao Telecom would have started delivering financial services based on it license for its "M-Money" product.
[339] Paragraph 30 is a specific example of the more general need for TA/training found in paragraph 29. It is however an example of central importance.

IV. EVALUATION STUDY TOURS

33. **Introduction**. As agreed during inception between the government and ADB, as a main activity under Component 2 a total of four study tours have been organized with the objective of enhancing BOL's RMF supervisory capacity. Related, four different BOL delegations have been designed, three of which consisting of a member of management and experienced technical officers of the respective FISD divisions for On-Site Inspection, Off-site Analysis and Legal issues; a fourth delegation was designed to consist of top-level management of BOL and a member of the Agricultural Promotion Bank's management. The study tours were intended for the delegations to learn from methodologies, existing good practice and experience gained related to supervision in neighboring Southeast Asian countries with well established RMF supervisory frameworks and well developed RMF sectors, or at least well developed sub-sectors that correspond to the specific topic of the particular study tour. Learning objectives were identified jointly with the relevant BOL officials, FISD management and delegation members and were sent to the hosts prior to the visit. The delegations requested for ample time for Question & Answers (Q&A), in order to be able to probe issues relevant for the Lao situation and allow for in-depth analysis.

34. **The study tours.**[340] As a part of all four study tours (to the Philippines, Cambodia, Indonesia and Malaysia) the Central Banks were visited; two industry representing organizations MFIs (the National Credit Council on the Philippines and the Cambodian Microfinance Association) and three successful RMF providers (CARD MRI on the Philippines, ACLEDA Bank in Cambodia and BRI in Indonesia).

35. **Learning objectives.** Learning objectives were related to the topics of on-site inspection of RMF providers, including specifically pawn shops; off-site analysis; the necessary policy and management reforms that allow for transforming a loss-making, inefficient state-owned rural policy bank to a healthy, self-sufficient and market oriented RMF provider with ample outreach; and building financial sectors inclusive for micro, small and medium enterprises. Additionally, the role of MFI-representing organizations in raising industry standards, as well as the functions of internal control and management structures within RMF providers in creating sound institutions and interrelationship between the development of these functions and Central Bank supervision were important lessons learned.

36. **Effectiveness of the study tours held**. Generally, the study tours have been highly appreciated and seen as very useful. However, relevance for actual supervisory work scored lower; in as far as the study tours were considered relevant for supervisory work it was considered more of long-term, strategic importance than of value for enhancing capacity to deal with tasks stemming from responsibilities for day-to-day work, in form of lessons learned which would be directly applicable. Related, there was a general appreciation for in-depth learning sessions on specific

[340] Detailed evaluations of the study tours held, including learning objectives, institutions visited and both quantitative and qualitative assessment of various aspects of the study tours can be found in the complete Evaluation Reports which have been added to this report as Appendices 1 to 4.

topics that are directly relevant to their work and time for discussion, and Q&A as ways to enhance effectiveness; both were considered to small a part of the study tours. A critical issue is the lack of English language proficiency, the existing lack of which strongly hinders the learning experience; without adequate interpretation support the study tours in its current form should be reconsidered. Tailor-making a study tour on the specific learning objectives related to directly applicable lessons in support of daily work combined with ample time for Q&A are seen as of central importance in creating a worthwhile learning experience.

Appendix 1. Evaluation Study Tour no. 1 to the Philippines

Evaluation Study tour to Philippines, 21-28 November 2010

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

"Strengthening Institutional Capacity of the Financial Institution Supervision Department of the Bank of Lao PDR"

Photo: Delegation from the Bank of Lao PDR's Financial Institution Supervision Department in front of the head-office of the Asian Development Bank, Manila, the Philippines, November 2010

Prepared for the Asian Development Bank, Southeast Asia Department

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January 2011

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Abbreviations and acronyms

ADB	Asian Development Bank
BOL	Bank of the Lao PDR
BSP	Bangko Sentral ng Filipinas (the Central Bank of the Philippines)
CARD	Center for Agriculture and Rural Development
CARD MRI	CARD Mutually Reinforcing Institutions
CMDI	CARD MRI Development Institute
D-DG	Deputy-Director General
FISD	Financial Institution Supervision Department
MF	Microfinance
MFI	Microfinance Institution
NCC	National Credit Council (Microfinance industry representing body of the Philippines)
RMF	Rural and Microfinance

Executive summary

As part of the activities under component 2 of the ADB TA-LAO 7500 aiming to enhance the capacity of the Bank of Lao PDR (BOL) to supervise the Rural and Microfinance sector in the Lao PDR, the 1st of an intended total of 4 study-tours has been organized.
The study-tour has brought a BOL delegation, consisting of experienced technical-officers of the On-Site Inspection Division of the Financial Institution Supervision Department (FISD) and a FISD Deputy-Director General, to the Philippines late November 2010.
On the Philippines, visits have been be paid to the Central Bank of the Philippines (BSP), the National Credit Council (NCC), an microfinance industry representing organization on the Philippines, and CARD, a large and successful RMF provider. The program took 5-days excluding international travel. Two days would be spent with BSP, half a day with the NCC, including a brief visit to the ADB head-office, and two days with CARD. Learning objectives had been defined and send prior to the hosts prior to the visit. The BOL delegation had requested for ample time for Question & Answers, in order to be able to ask probe issues relevant for the Lao situation and do an in-depth analysis.

The study-tour has been highly-useful as indicated by an average score of 4.75 given by the delegation members, when a 5 score would have been the maximum. The lessons learned are more of strategic than practical use and the study-tour should be seen as a beginning rather then an end to the process of supervisory capacity development of the FISD.
Still, the study-tours' effectiveness can be enhanced by having fewer visits, loosing less time for travel, dealing with fewer topics, spending more time with BOL's counterpart in a country -that countries Central Bank- and, importantly, allowing ample time for a Questions & Answers session. A study-tour should enable in-depth analysis on topics and learning objectives relevant to the responsibilities and tasks at hand for the particular delegation.
For the success of a study-tour for BOL staff, it is most clear that the presence of an adequate interpreter is elementary: the lowest and most significant score of only 2.25 on the question of English proficiency speaks for its self, in particular in the light of high-scores on the various elements of the usefulness of the study-tour.

Introduction

1. **Background**: The Bank of Lao PDR's (BOL) Financial Institution Supervision Department (FISD) is responsible for supervision of all non-bank, non-insurance financial institutions in the Lao PDR. The FISD has 4 divisions: On-site Inspection; Off-site analysis; Legal; and Management Information & Statistics. In the framework of Asian Development Bank's (ADB) TA 7500, component 2, which aims to strengthen BOL's supervisory capacity over Laos' the rural and microfinance (RMF) sector and for which the FISD is the counterpart, a first of a total of 4 study tour has been organized. For the first study tour, the Philippines were the destination.

2. **Objective**: Central objective is for the Lao delegation to learn from methodologies, existing good practice and experience gained related to supervision, in particular to on-site inspection, of (rural and) microfinance providers and pawn shops. The Philippines are known for its well organized supervision over the RMF sector, which has enabled the sector's development. Moreover, with regard to supervision over pawn-shops, "Bangko Sentral ng Pilipinas" (BSP) or the Central Bank of the Philippines), has quite recently engaged in a major operation to organize and set-up a system. In the Lao PDR, other providers than microfinance institutions and pawn-shops deliver services to the RMF segment. However, the supervision over microfinance institutions (MFIs) and pawn-shops is in the hands of the FISD, counterpart of component 2 as mentioned, and is in acute need of improvement.

3. **Delegation**: The delegation consisted of experienced staff of the FISD's On-Site Inspection Division and the responsible FISD Deputy-Director General. Delegation members were:

From FISD[341]:
1. Mr. Amphone Aliyavongsing (Deputy-Director General)
2. Mr. Varasine Dalaphone
3. Mr. Tona Vongpaseuth
4. Ms. Chansamone Jitthivong
5. Ms. Sisouvanh Sisavath

Interpretor:
6. Ms. Sinipha Khamphoui

4. **Institutions visited and program outline**: During the study tour, visits have been be paid to BSP, the National Credit Council (NCC), an microfinance industry representing organisation on the Philippines, and CARD, a large and successful RMF provider. This way, lessons could be learned both from the different stakeholders in the process of supervision, in particular from the supervisor (BSP), an industry representing organisation or multi-stakeholder platform (NCC) and a subject of supervision MFI (CARD). The program would take 5-days excluding international travel. Two days would be spent with BSP, half a day with the NCC, including a brief

341 At the last moment Mr Varasin Dalaphone had been informed he was not in the position to go on the study-trip, as the final and a most relevant game of the BOL football team, of which Mr Varasin is the captain, had to be played in the Lao PDR football competition. Fortunately his participation paid off and after the match BOL was able to lift the trophy as champions.

visit to the ADB head-office, and two days with CARD. Specifically, the BOL delegation had requested for ample time for Question & Answers, in order to be able to ask probe issues relevant for the Lao situation and do an in-depth analysis.

Learning objectives

5. **The learning objectives** as formulated by the delegation members can be found below in **section B** of the evaluation of the study tour. Learning objectives relating to the visit to BSP have been separately specified for MFI supervision and for supervision of Pawn shop. They are followed by learning objectives defined for the visit to the NCC and those defined for the visit to CARD. The learning objectives had been sent to the host-organisers enabling their preparation of the visit.

Evaluation

6. **The evaluation of the study-tour** consists of three parts. The first part assesses the overall success of the study tour and is titled **"A. Overall Evaluation"**. Secondly, an evaluation is made of the extent to which the specific learning objectives have been accomplished for each of the institutions, specified per topic. This part can be found below **"B. Attainment of specific learning objectives".** Both these two parts use a score from 1 to 5, based on the average of all four delegation members, where a 1 indicates the delegation completely not agrees and a 5 score means the delegation fully agrees. Finally in the **section C**, a summary of qualitative reflections made by the delegation members is given.

7. **Quantitative: scoring**
The scoring system is based on the average of the individual scores given by the delegation members on a scale wherea score of **1** means fully **not agree** and **5** score means fully **agree:**

A. Overall Evaluation

General:

i. The study tour was useful**: 4.75**
ii. The study tour has improved my knowledge: **4.25**
iii. The knowledge I have acquired from the study tour is of relevance to my work: **4.75**
iv. The knowledge I have acquired from the study tour is immediately applicable in daily practice of my work: **3.75**
v. The knowledge I have acquired from the study tour is of long-term strategic importance to my work: **4.5**
vi. I understand enough English do make the study visit worthwhile without interpreter: **2.25**
vii. The duration of the study tour was just right: **3.25**

On BSP:

viii. The presentations were relevant: **5**
ix. The presentations were of good-quality: **4.5**
x. There was enough opportunity for Questions & Answers: **3.5**

On NCC

xi. The presentation(s) were relevant: **4**
xii. The presentations were of good-quality: **4.25**
xiii. There was enough opportunity for Questions & Answers: **3.75**

On CARD MRI

xiv. The presentation(s) were relevant: **4.75**
xv. The presentations were of good-quality: **4.25**
xvi. There was enough opportunity for Questions & Answers: **3.75**

B. Attainment of specific learning objectives

Here the score indicates in how far a learning objective has been met: 1 means the delegation has not learned anything on that topic, 5 means the delegates have learned very much on that topic. The questions on the visit to BSP are divided in a part on microfinance and a part on pawn-shops:

BSP: Supervision of Microfinance providers

i. **Supervision**: What is the view on purpose or objective of supervision? Where does the responsibility of the supervisor stop and the responsibility begin? How detailed should the supervisor's regulations be? **4.25**
ii. **On-site inspection**: The same questions as mentioned below 1, but specifically for On-site inspection or examination? How does BSP organize the process of the examination? What specific procedures does it use during On-site examination? **4.5**
iii. **Report**: For the BSP, who is the main recipient of intended beneficiary of the report (BSP or MFI)? What is the report's main intended purpose? How many pages should it contain? What subjects should be elaborated on? **4.75**
iv. **Compliance and follow-up**: After issues have been identified and addressed, both in the report and verbally, what does the BSP do to ensure compliance? How to solve problems or challenges that have been identified? When should enforcement start? Which measures of enforcement are appropriate related to the various issues of non-compliance? How to check if MFIs comply with instructions given after an inspection? **5**
v. **Reporting and communication**: How is communication between BSP and MFIs organized? Is it done mainly electronically? What forms and reports are required for the MFIs to be sent to BSP and for which purposes? **3.75**

BSP: Supervision of pawn shops

vi. **Set up supervision framework**: How BSP has set up its supervision framework as well as how it manages to supervise all pawn-shops and include the ones that haven't received a license? **4.5**
vii. **Organization and planning**: Estimations of needed frequency, time and human resource to monitor pawn-shops: **4.5**
viii. **Purpose and focus supervision**: Main risks in the operations of Pawn-shops or main topics for supervision, e.g. money-laundering, consumer

protection (in Laos interest rates are maximized for Pawn-shops and only certain moveable assets are allowed as Pawn) etc: **4.5**

NCC

ix. **To learn from and understand**: The vision, mission and objectives as well as the different policies, including the MFI's Code of Ethics, as developed by the National Credit Council in relation to the Philippine microfinance industry: **4.25**

CARD

x. **To learn from and understand CARD as an organization:** The background, vision, mission and its operating systems and procedures, including CARD Bank's strategies in ensuring smooth implementation of the program and addressing issues and concerns: **5**

xi. **Understand (the importance of) setting up sound accounting systems**: Both for the purpose of internal control and management as for reasons of compliance with prudential regulation and on-site inspection by BSP: **4.25**

xii. **Understand (the importance of) setting up sound internal audit systems and policies:** Both for the purpose of internal control and management as for reasons of compliance with prudential regulation and on-site inspection by BSP: **4.75**

8. Qualitative: reflection and comments

C. Summary comments delegates

In general the study-tour is assessed to be of good quality. The study tour could however be improved if less time would be lost on travel, if fewer institutions would be visited and (much) more time for Q & A would be reserved in stead of having to (passively) having to listen to a large number of presentations. The delegation would prefer to have in-depth learning sessions on the few topics that are directly relevant to their work. Related, the delegation indicates the visit to BSP was the most important of all visits and should have been given more time. The delegation stresses the importance of having an interpreter and mentions without interpretation the study-tour would not have been able to be successful. Finally, the delegation-leader has added the importance for the TA consultant to join the study-tour.

9. Conclusion and lessons learned

The 1st study tour to the Philippines has been successful as a tool to enhance the capacity of the FISD, in particular of the FISD's On-Site Inspection Division, to supervise the RMF sector in the Lao PDR. The lessons learned are more of strategic than practical use and the study-tour should be seen as a beginning rather then an end to the process of supervisory capacity development of the FISD[342].
For next study-tours it is most clear that the presence of an adequate interpreter is elementary: the lowest and most significant score of only 2.25 on the question of

342 See also the final paragraph of the Annex, containing the debriefing report on the study tour (284/FISD, 14/12/2010), written by the delegation leader and FISD D-DG Mr Amphone Aliyavongsing

English proficiency is clear, in particular in the light of a score of 4.75 on overall usefulness of the study-tour.
The study-tours' effectiveness can be enhanced by having fewer visits, loosing less time for travel, dealing with fewer topics, spending more time with BOL's counterpart in a country -that countries Central Bank- and, importantly, allowing ample time for a Questions & Answers session. A study-tour should enable in-depth analysis on topics and learning objectives relevant to the responsibilities and tasks at hand for the particular delegation.

Annex

Translation of No. 284/FISD, 14/12/2010: Debriefing report on the study tour, written by the delegation leader and FISD D-DG Mr Amphone Aliyavongsing

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity
****

Bank of the Lao PDR Ref. 284/FISD
Financial Institutions Supervision Department Vientiane Capital, 14 December 2010

To: Governor of the Bank of the Lao PDR
Mr. Bounsong Sommalavong, Deputy-Governor of the Bank of Lao PDR (Supervisor for Financial Institutions Affairs)
Sub: Report on the results of our Philippines study tour on the topic of "On-site inspection to supervise Financial Institutions and its regulations, and managing the process of supervising pawn-shops".

Based on the agreement Ref No. 879/BOL, dated 15 November 2010 regarding the assignment for our bank staff to participate in the study tour in Philippines.

I. Delegations Members

1. Mr. Amphone Aliyavongsing, Deputy Director General
2. Ms. Chansamone Chitthivong, Technical staff
3. Ms. Sisouvanh Sisavath, Technical staff
4. Mr. Tona Vongpaseurth, Technical staff

We would like to report the result of the study tour in Philippines under the topic "On-site inspection to supervise Financial Institutions and its regulations, and managing the process of supervising pawn-shops" from 22-27 November 2010.

Our delegations attended and listened to the lectures presented by staff members from the Central Bank of the Philippines, Ministry of Finance, and CARD Institution.

II. Contents of the Study Tour

1. History and General Situation of Financial Institution

In 1960s-70s, the government developed a microfinance program that offered low-interest loans directly to poor people. Private Financial institutions could not compete with government interest rates and it caused high NPL. Loans were being given to people the government knew, not to the expected beneficiaries, i.e., the poor. As a result, the direct loan program was neither successful nor sustainable.

In 1980, the government recognized that the direct loan program was not successful. The government issued national regulations stated that government shall not underwrite loans directly to individuals. The government decided that microfinancing should be operated by the marketplace, i.e., through the private sector.

In 2002, the government issued a provision for microfinance institution, which defined the structure that includes following stakeholders, as noted below.

- Central Bank will oversee all banks including those which provide microfinance services
- Ministry of Finance
- Ministry of Commerce

Philippine banking system is divided into 3 types.

- Commercial Bank
- Thrift Bank
- Cooperative Bank

The government realized that a microfinance strategy is important for poverty reduction. They believe that microfinance lending should be implemented through the banking system. Banks have a number of channel and service options that could make microfinancing available to all eligible individuals to access.

The Central Bank issued policies and regulations to administer and to enable banks, particularly commercial banks, to offer microfinance products and services. In total, there are 8584 banks in Philippines with 785 Head Offices, 7035 branch offices, 8458 ATM, and 99 banks providing e-Banking. Currently, there are 212 banks providing microfinance products and services.

The Central Bank adopted 224 policies in support of microfinance lending within the banking system. This included 496 compliance guidelines, where non-compliance could result in penalties. One key provision states that banks offering microfinancing must allocate 50% of its assets (or loan portfolio) to microfinancing.

The Central Bank's role, in addition to establishing policies and guidelines for the commercial banks is to audit the commercial banks under the CAMEL principles. CAMEL and PESO principles are used to monitor microfinance operations (PESO—Philippine currency). Analysts monitor the operations daily. Their job focuses on ensuring that the bank are in compliance with Central Bank as well as commercial bank's policies, guidelines and audit requirements. Auditors audit once a year and support the analysts in preparing for compliance audits. After auditing, the report is sent to the Center of Coordination (CPC). CPC gives direction and coordinates with Commercial Banks to define risks.

Following are the audit procedures.

- Two weeks preparation before audit takes place
- Inform the banks about the audit goals and process, i.e., indicating that the audit will take 2 weeks to a month per bank, two auditors will audit the banks whose services are microfinance, and 4 auditors will audit Commercial Banks.
- Interview staff
- Ask for documents and other information to analyze

- Auditors give comments and recommendations after auditing into the format
- Two reports will be produced as follows:
    - A preliminary report— used for discussion and consultation. Auditors will inform the banks what they found, particularly exceptions, before finalizing the audit
    - A complete report - which takes 3-6 months to write and is approved and signed by a vice-governor (supervisor)

2. History and the supervision of pawn-shops

In 1944s, lenders were operated by police. In 1973, the government issued Decree No. 114 to administer and to communicate with all pawn-shops. Currently, there are 15,324 pawn-shops with 6,324 head offices and 8,997 service units.

- Establishment
    - Central bank controls the registration and issues a business operation certification (in the case of closure or change the location of business)
    - Business operation permission letter is issued by district
    - The directors of the pawn-shops attend a seminar to listen to antimony laundering lectures, organized monthly by the Anti-Money-Laundering-Intelligence Unit
    - Must have 100,000 Peso (around US$ 2000) working capital
    - Pays a registration fee of 1000 Peso (non-refundable)
    - Pays an administration fee is 3000 Peso for 3 years
    - Must establish a settlement acount with the Central Bank
    - Maintains a asset collection/income records that is submitted to the Central Bank annually by each June
    - Central Bank needs two weeks to study before issuing a business operation certificate. People living in provinces can request a business operation certificate from the branch office
    - Pawn-shops can operate other business such as: money exchange, money transfer, pay bill for water supply and electricity.
- Analysis is conducted annually from the day the business certificate is issued. The analysis is done based on the pawn-shops reporting submitted to the Central Bank
- Audit is conducted based on the annual plan. There are two types of audit:
    - General audit
    - Audit in region (zone) and audit based on the request from people
    - For a big companies, it takes 2 weeks to audit and will use 3-4 auditors
    - After audit, two copies of the report will be made — one for the pawn-shop which has seven days to review and respond to the Central Bank, and the other copy is for the record for the next audit
- Voluntary closure of business: Pawn-shops sends a letter for clearance to its customers. Central Bank gives 3 months to a pawn-shop to clear with its customers
    - District will issue a letter of closure of business
    - Central Bank will collect back the business operation certificate and other clearance
- Closure of business by force: when a lender does not submit a financial report for 3 consecutive years

3. History of NCC (National Credit Council)

In 1970s to 1980s to beginning of 1990s, the government did not have a policy to allow private financial institutions to lend money to consumers, because such institutions were not financially stable and relied on the government for stability. Poor people did not have the ability to borrow money from financial institutions. By the end of 1990s, the NCC in collaboration with the Ministry of Finance assessed the situation by reviewing the issues with the private sector and NGOs (non-government organizations). Representative from NGOs had been working with NCC to review and assess lending policies if they were aligned with government policies and regulations, and their impact on the state budget. The study took two years to complete. Following are some of the conclusions.

Microfinance operation strategy should be operated by people not the government. Four main principles and four operation solutions were defined.

1. Get more participation from private sector
2. Focus on available environment such as policies and regulations
3. Implementation should be based on market mechanism
4. Program should not be operated by government such as:
   - He is one customer
   - Lend monies based on market mechanism
   - Self-reliance
   - Government cooperates with private sector by establishing policies, guidelines and oversight
   - Partner and collaborate to exchange ideas, strategies, tactics and lessons learned in helping set future direction
   - Provide training and advocacy to the private sector and Ministry of Justice not to loan to general people.

4. History of CARD Institution

CARD was established in 1986. It was started from the NGO (Rural Development Bank) by Mr. Arif in collaboration with UNCDF. In 1997, the NGO was changed to a bank, becoming CARD Bank (Any institutions who wanted to expand the branch office to a bank had to apply to Central Bank.) Since CARD was an NGO, it could expand the branch without obtaining permission.

In 1999, the government considered the needs of people. They learned that people not only wanted to deposit money and borrow money, but also wanted insurance. CARD established an organization to provide insurance to people. In 2005, a training center was established to provide financial literacy training. In 2007, this training center worked with insurance companies to sell to poor people a range of insurance products, e.g., homeowner’s insurance, health insurance, accident insurance, etc. 60% of its customers were microfinance customers. In the same year, CARD bought the share of Rural Development Bank’s business and became a commercial bank. In 2008, CARD realized that people faced difficulty in running business, e.g., not understanding the markets to sell their products. CARD began to find markets for its customers with cooperation from private sector businesses. Now, CARD has 39 branch offices nationwide and 113 service units.

III. Lesson learned, and the implementation in our country

1. Lesson learned

The supervision by the Central Bank in Philippines relates to many sectors particularly Central Bank, Ministry of Finance, Ministry of Commerce etc. The role of Commercial Banks is to provide microfinance service and other services. The Central Bank's role is oversight of the commercial banks. Central Bank in collaboration with NCC issue policy on supervision and improvement to ensure compliance on an annual basis. They monitor the banks on an ongoing basis.

- There is a continuous human resource development; they develop their personnel to become professional. As can be seen, three staff is the maximum staff requirements to audit one institution.
- In order to ensure a financial Institution's sustainability, every financial institution should be audited regularly and systematically by the Central Bank. All financial institutions are requested to be audited by an outside audit firm.

The role of Bank of the Lao PDR is to audit and supervise. It also supports and issues policies on supervision. The activity of financial institutions is to provide financial services (e.g., microfinancing), but to comply with the Bank's policies, regulations. Late August 2010, a separate department has been created in BOL to supervise financial institutions. In order to comply with central bank policies and regulations effectively, it needs time to develop its personnel and its own regulation

IV. Proposal

In order to help supervise financial institutions effectively and to ensure the smooth implementation, there are many steps to be used in supervision such as policies, and the issuance of provisions, regulations, and to follow up regularly. Our proposal follows.

1. Build and train the staff of the Financial Institution Supervision Department to become professional on audit policies and procedures by providing training and by studying central banks of other countries to understand their policies, regulations and implementations, and improve their skills on the international standard.
2. Expand the next training timeframes. There are so many lessons to learn and exchange but time was limited. As a result, we could not learn as much as we should to be effective in implementing policies and regulations that are required for our country.

Therefore, we submit this report to you for your information and for your direction.

Sincerely,

Mr. Amphone Aliyavongsing

Sent to:

1. Governor of the Bank of Lao PDR
2. Deputy Governor of the Bank of Lao PDR (Supervisor for Financial Institutions)
3. Personnel and Organization Department
4. International Relations Department
5. Financial Institution Supervision Department

Appendix 2. Evaluation Study Tour no. 2 to Cambodia

Evaluation Study tour to Cambodia, 9-12 May 2011

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

"Strengthening Institutional Capacity of the Financial Institution Supervision Department of the Bank of Lao PDR"

Prepared for the Asian Development Bank, Southeast Asia Department

May 2011

Abbreviations and acronyms

ADB	Asian Development Bank
BOL	Bank of the Lao PDR
CMA	Cambodian Microfinance Association
NBC	National Bank of Cambodia
D-DG	Deputy-Director General
FISD	Financial Institution Supervision Department
MF	Microfinance
MFI	Microfinance Institution
RMF	Rural and Microfinance

Executive summary

As part of the activities under component-2 of the Asian Development Bank (ADB) TA-LAO 7500, aiming to enhance the capacity of the Bank of Lao PDR (BOL) to supervise the Rural and Microfinance (RMF) sector in the Lao PDR, the 2nd of an intended total of 4 study-tours has been organized.
The study-tour has brought a BOL delegation, consisting of experienced technical-officers of the Off-Site Analysis Division of the Financial Institution Supervision Department (FISD) and a FISD Deputy-Director General (D-DG), to Cambodia 9-12 May 2011.
During the study tour to Cambodia, organized by the ACLEDA-ASEAN Regional Microfinance Center, visits have been paid to the National Bank of Cambodia (NBC), the Cambodian Microfinance Association (CMA) and the Legal & Corporate Affairs Division of ACLEDA Bank Plc. The duration of the program has been 2-days, excluding international travel. During the training, the delegation stayed in training rooms provided by ACLEDA and listened to presentations by the 3 organizations mentioned; 1 day was spent on NBC, half a day on CMA and half day on ACLEDA Bank Plc. Learning objectives had been defined and sent to the hosts prior to the visit. The BOL delegation had requested for ample time for Question & Answers, in order to be able to probe issues relevant for the Lao situation and do an in-depth analysis.

The study-tour has been highly-useful as indicated by an average score of **4.7** given by the delegation members, when a 5 score would have been the maximum. The lessons learned can be immediately applied in order to improve in daily practice of the work.
Still, the study-tour's effectiveness can be enhanced by allowing ample time for a Questions & Answers session. To ensure maximize effectiveness, the study-tour should allow in-depth analysis on topics and learning objectives relevant to the responsibilities and tasks at hand for the particular delegation, while presentations should not overlap.

Introduction

1. **Background**: BOL's FISD is responsible for supervision of all non-bank, non-insurance financial institutions in the Lao PDR. The FISD has 4 divisions: On-site Inspection; Off-site Analysis; Legal; and Management Information & Statistics. In the framework of ADB's TA 7500, component 2, which aims to strengthen BOL's supervisory capacity over Laos' rural and microfinance (RMF) sector and for which the FISD is the counterpart, the second of a total of 4 study tour has been organized to Cambodia.

2. **Objective**: Central objective is for the Lao delegation to learn from methodologies, existing good practice and experience gained related to supervision, in particular to off-site inspection, of (rural and) microfinance providers. Cambodia is known for its well organized supervision over the RMF sector, which has enabled the sector's development.

3. **Delegation**: The delegation consisted of experienced staff of the FISD's Off-Site Analysis Division and the responsible D-DG. Delegation members were:

From FISD:

6. Mr. Amphone Aliyavongsing (Deputy-Director General)
7. Mr. Veunsavanh Sivixay
8. Mr. Saykham Damlongboun
9. Ms. Latsany Lounnavandy
10. Mr. Yearlor Hongnou
11. Ms. Chansamone Chanthavong

Interpreter: provided by ACLEDA Bank Plc., the organizer

4. **Institutions visited and program outline**: During the study tour, visits have been be paid to the National Bank of Cambodia (NBC), Cambodia's Microfinance Association (CMA) and Legal & Corporate Affairs Division of ACLEDA Bank Plc. The program took 4-days including international travel. One day was spent on NBC, half a day with the CMA and half day with ACLEDA Bank Plc. Specifically, the BOL delegation had requested for ample time for Question & Answers, in order to be able to ask probe issues relevant for the Lao situation and do an in-depth analysis.

Learning objectives

5. **The learning objectives** as formulated by the delegation members can be found below in **section B** of the evaluation of the study tour.

Evaluation

6. **The evaluation of the study-tour** consists of three parts. The first part assesses the overall success of the study tour and is titled **"A. Overall Evaluation"**. Secondly, an evaluation is made of the extent to which the specific learning objectives have been accomplished for each of the institutions, specified per topic. This part can be found below **"B. Attainment of specific learning objectives".** Both these two parts use a score from 1 to 5, based on the average of all 6 delegation members.

Regarding **"B. Attainment of specific learning objectives"**, participants have given brief comments per learning-objective, next to the score. Finally in the **section C**, a summary is made of the overall qualitative reflections that have been given by the delegation members.

7. **Quantitative: scoring**

The scoring system is based on the average of the individual scores given by the delegation members on a scale wherea score of **1** means fully **not agree** and a **5** score means fully **agree:**

A. Overall Evaluation

General:

1) The study tour was useful**: 4.7**
2) The study tour has improved my knowledge: **4.2**
3) The knowledge I have acquired from the study tour is of relevance to my work: **4.5**
4) The knowledge I have acquired from the study tour is immediately applicable in daily practice of my work: **4.3**
5) The knowledge I have acquired from the study tour is of long-term strategic importance to my work: **4.3**
6) Translation was good and helpful: **4.5**
7) The duration of the study tour was just right: **4.0**
8) The presentations were relevant: **4.2**
9) The presentations were of good-quality: **4.2**
10) There was enough opportunity for Questions & Answers: **3.5**

On NBC:

1) The presentations were relevant: **4.7**
2) The presentations were of good-quality: **4.3**
3) There was enough opportunity for Questions & Answers: **4.0**

On CMA

1) The presentation(s) were relevant: **3.0**
2) The presentations were of good-quality: **3.7**
3) There was enough opportunity for Questions & Answers: **3.3**

On ACLEDA

1) The presentation(s) were relevant: **3.2**
2) The presentations were of good-quality: **3.7**
3) There was enough opportunity for Questions & Answers: **3.2**

B. Attainment of specific learning objectives

Here the score indicates in how far a learning objective has been met: 1 means the delegation has not learned anything on that topic, 5 means the delegates have learned very much on that topic. The questions on the visit are on supervision of microfinance providers and to compare with current situation in Laos:

1. **Supervision**: What is the view on purpose or objective of supervision? Where does the responsibility of the supervisor end and does the

responsibility of the MFI begin? How detailed should the supervisor's regulations be? **Our methods are more or less similar 3.2**

2. **Off-site inspection**: The same questions as mentioned below 1, but specifically for Off-site inspection or examination? How does NBC organize the process of the examination? What specific procedures does it use during Off-site examination? **4.3**
3. **Report**: For the NBC, who is the main recipient of intended beneficiary of the report (NBC or MFI)? What is the report's main intended purpose? How many pages should it contain? What subjects should be elaborated on? **From participants observation the report format required by NBC is shorter than what we have. Our report format is more detailed and comprehensive- 3.8**
4. **Compliance and follow-up**: After issues have been identified and addressed, both in the report and verbally, what does the NBC do to ensure compliance? How to solve problems or challenges that have been identified? When should enforcement start? Which measures of enforcement are appropriate related to the various issues of non-compliance? How to check if MFIs comply with instructions given after of inspection? **The participants agreed that NBC is doing better regarding compliance and monitoring e.g. penalized late submission of report- 4.7**
5. **Reporting and communication**: How is communication between NBC and MFIs organized? Is it done mainly electronically? What forms and reports are required for the MFIs to be sent to NBC and for which purposes? **Similar system, but better, regular reporting from MFIs- 4.3**

8. Qualitative: reflection and comments

C. Summary comments delegates

- In general the study-tour is assessed to be of good quality and useful.
- The study tour could however be improved more time for Q & A would be reserved in stead of having to (passively) having to listen to a large number of presentations some are repeated.
- Some presentations were deemed not really related to objective of the study tour (e.g.CMA).
- The delegation indicates the presentation by the NBC was the most important of all and should have been given more time.
- The delegation expresses that the study tour should combine between presentations with field visit, instead of spending all the time in the conference room and should allocate some time to go out to the field to talk with some MFIs.
- The conference room was small and noisy.
- The delegation stresses that, Lao translation provided by the organizer during the visit was good quality and helpful.
- Transportation, food and hotel were good.
- Time was short

.

9. Conclusion, lessons learned and recommendation

As indicated by a score of **4.7** (on a scale of 5) for overall usefulness of the study-tour, the study tour has met the participants' expectation and has been judged effective. We also conclude the 2nd study tour to Cambodia has been successful, as a tool to enhance the capacity of the FISD, in particular of the FISD's Off-Site Analysis Division, to supervise the RMF sector in the Lao PDR. The lessons learned can be immediately applied such as to improve reporting system in a regular and on-time basis, penalty on late submission of MFIs reports could be used.

The study-tours' effectiveness can be enhanced by allowing ample time for a Questions & Answers session. To ensure that the presentations are related, not repeated and a study-tour should enable in-depth analysis on topics and learning objectives relevant to the responsibilities and tasks at hand for the particular delegation.

The delegation mentioned it is important to combine and balance between theory / presentations with field visits to have more practical approach of learning in order to increase effectiveness of learning. The delegation also noted the importance of seeing the country while visiting and that time allocation could be improved. With the latter the participants intended to say the study tour should be longer. The interesting part here is that it has been at the explicit request of the FISD management that the original schedule, which planned to have room for a visit to cultural sites and some relaxation as well as more time for learning and Q & A, has been shortened. This only shows the importance of good internal coordination and alignment of objectives within the FISD.

Annex

Translation of No. 417/FISD, 13/05/2011: Debriefing report on the study tour, written by the delegation leader and FISD D-DG Mr Amphone Aliyavongsing

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity
****

Bank of the Lao PDR — Ref. 417/FISD
Financial Institutions Supervision Department — Vientiane, 13 May 2011

To: Mr. Phouphet Khamphounvong,
Governor of the Bank of the Lao PDR
Sub: Report on the results of BOL study tour to Cambodia.

Based on the agreement Ref No. 361/BOL, dated 6 May 2011 regarding the assignment for our bank staff to participate in the study tour to Cambodia.

As a head of the BOL delegation to visit Cambodia, I am pleased to report to Your Excellency on the result of the study tour on off-site inspection MFIs. Dates 9-12 May 2011. Detials are as follows:

III. Expenditure

The study tour was support by ADB TA7500-LAO, this covers the cost of hotel, food, transportation and training fee

IV. Venue/organizer

The study tour was organized by ACLEDA Ltd. The speakers/resource persons were invited from NBC, Director of Cambodia Microfinance Association (CMA), and the director of ACLEDA Bank Plc. to give presentations.

V. Contents of the Study Tour: There are 4 main topics:

4. Regulation to supervise MFIs in Cambodia: have leant about process/steps and methodologies of off-site inspection and analysis of NBC
5. NBC supervision and analyze MFIs, learnt about role and responsibility of NBC in supervising MFI, legal framework, methodologies of analysis MFIs financial status, steps, planning and methodology of off-site inspection MFIs. The international standards of analysis CAMEL is used.
6. Implementation of regulation:
    a. CMA was established in 2004. The aims is to help the poor in remote areas to access fund in order to improve their living condition and to facilitate MFIs in strengthening their capacity and coordination with the government organizations and donors both local and international.
    b. The key achievement of the CMA during the duration of 2004-2010: Providing training to MFIs members, dissemination related regulations, procedures and laws to people in remote areas, organizing experience sharing workshops with MFI supervisions organization in the region and Europe

c. Legality of supervision MFIs in Cambodia is similar, however, there is something different such as registration fee for DT MFI in Cambodia is 2,500,000 USD but in Laos 1,000,000,000 LAK (125,000 USD)

7. ACLEDA experience of being ready to facilitate NBC annual inspection

IV. Lesson learned

Main lesson learned from this study visit is to improve timely reporting of MFIs: Monthly report to be submitted not later than 15th of consecutive month, quarterly report to be submitted not later than 15th of consecutive month, annual report to be submitted not later than 15th of third month consecutive year. Delayed submissions of the report would be penalized with number of overdue days. Learned about how consolidate financial data for analysis and able to follow up the way that MFIs dial with delinquent.

Therefore, we submit this report to you for your information and for your direction.

Sincerely,

Mr.Amphone Aliyavongsing

Sent to:

6. Governor of the Bank of Lao PDR
7. Personnel and Organization Department
8. BOL cabinet
9. Financial Institution Supervision Department

Appendix 3. Evaluation Study Tour no. 3 to Indonesia

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

Evaluation Report

Study tour to Indonesia, 11-15 July 2011

Prepared for the Asian Development Bank, Southeast Asia Department

By Vanhsy Chindavong

National Microfinance Specialist/consultant

August 2011

Executive summary

As part of the activities under component 2 of the ADB TA-LAO 7500 aiming to enhance the capacity of the Bank of Lao PDR (BOL) to supervise the Rural and Microfinance sector in the Lao PDR, the 3rd of an intended total of 4 study-tours has been organized.
The study tour originally planned to be organized early 2011. The plan was postponed due to time constraint of the receiving country, Indonesia. However, BOL was keeping its endeavor to organize the study tour, in order to learn about supervision model of financial institutions in Indonesia, the model is working well. This is an executive study visit for 6 members of high level of BOL management and Agriculture Promotion Bank (APB), who have important influencing role in policy making of the sector. The TA consultant team had good communication with BRI who organized the study visit. BOL had made change to the original participants list due to the vice governor could not join the visit. Actually BOL could send only 4 participants to Indonesia due to an urgent matter and sickness.

On Indonesia, visits have been be paid to the Central Bank of Indonesia, Bank Rakyat of Indonesia Head office in Jakarta and its branch office in Yogyakarta, a bank who is delegated by the Central Bank of Indonesia to supervise microfinance institution .
The program took 6-days excluding international travel. Half a day spent with Central Bank of Indonesia, half a day attended the workshop at BRI head office in Jakarta and another day in Yogyakarta visit to BRI branch office. Learning objectives had been defined. But majority the participants who actually participated the study visit were not the right target, they are not high decision making level. Therefore, it is difficult to evaluate the outcome of the visit against its original objective.

However, the study-tour has been highly-useful as indicated by an average score of **4.75** given by the delegation members, when a 5 score would have been the maximum. However, the study tour does not much improve knowledge of the participants average scores are between **3.0 and 3.75**. This due to the initial design of visit was more for higher level of management. The lowest and most significant score on English proficiency only **2.5**.

1. Introduction

1. **Background**: the study tour was organized to Bank Rakyat Indonesia (BRI). This, because in the Lao PDR banks, one of which importantly the state owned APB, have the potential of playing a crucial role in delivering financial services to the RMF segment, yet are hindered by a set of institutional constraints. In Indonesia, a series of policy and management reforms has made the state-owned BRI, which delivers services to the rural areas in Indonesia, from a loss-making inefficient organization into one of the success-stories in microfinance, both in terms of outreach and in terms of financial self-sufficiency. As the Indonesian situation and BRI used to have some characteristics similar to the situation in the Lao PDR (process of letting go of control over state-owned banks into more market-oriented system, Central Bank under Ministry of Finance, large rural population, BRI is similar to APB a state-owned agricultural bank, the Indonesian Central Bank used to control the interest rate, used to fund state owned banks with "cheap" credit, monitors using CAMEL etc[343]). The visit could lead to renewed insights or inspiration on potential (state-owned) banking sector policy and management reforms. Therefore, the tour was proposed to include the Deputy-Governor, a senior official of the BSD (preferably the DG), the PMC Director, a senior-official of the FISD and senior officials of APB and LDB.

2. **Objective**: To learn from Indonesia experience on policy and management reforms has made the state-owned BRI, from a loss-making inefficient organization into one of the success-stories in microfinance, both in terms of outreach and in terms of financial self-sufficiency. And to incorporate lesion learnt to insights or inspiration on potential (state- owned) banking sector policy and management reforms.

3. **Delegation**: As already mentioned the original plan this would be an executive visit which include higher management members of BOL and the managing director of ABP. However, at the last day before the departure two senior management member could not join the trip, Mr. Arkhom Prasueth was hospitalized, Mr. Phanthaboun Sayyaphet had to stay due to ADB mission to BOL. Delegation members were:

- Mr. Bouanguen Phongsavath, Managing Director ABP
- Ms. Manosin Tandavong, Head of the division, FISD BOL
- Ms. Valasin Dalaphone, Technical staff, FISD BOL
- Ms. Avila Khounnavong, Technical staff, IRD BOL

4. **Institutions visited and program outline**: During the study tour, visits have been be paid to Central Bank of Indonesia, Bank Rakyat of Indonesia Head office in Jakarta and its branch office in Yogyakarta, a bank who is delegated by the Central Bank of Indonesia to supervise microfinance institution .
The program took 6-days excluding international travel. Half a day spent with Central Bank of Indonesia, half a day attended the workshop at BRI head office in Jakarta and another day in Yogyakarta visit to BRI branch office. Learning objectives had been

[343] Consultative Group to Assist the Poor, "Bank Rakyat Indonesia (BRI)" (Case Study), Klaus Maurer, Eschborn, 1999.

defined. But majority the participants who actually participated the study visit were not the right target, they are not high decision making level. Therefore, it is difficult to evaluate the outcome of the visit against its original objective.

Evaluation

6. **The evaluation of the study-tour**. The evaluation only can assesses overall success of the study tour. The overall evaluation use a score from 1 to 5, based on the average of all four delegation members, where a 1 indicates the delegation completely not agrees and a 5 score means the delegation fully agrees.

7. **Quantitative: scoring**

The scoring system is based on the average of the individual scores given by the delegation members on a scale wherea score of **1** means fully **not agree** and **5** score means fully **agree:**

Overall Evaluation

1) The study tour was useful**: 4.75**
2) The study tour has improved my knowledge:**3.75**
3) The knowledge I have acquired from the study tour is of relevance to my work: **3.75**
4) The knowledge I have acquired from the study tour is immediately applicable in daily practice of my work: **3.0**
5) The knowledge I have acquired from the study tour is of long-term strategic importance to my work: **3.5**
6) I understand enough English do make the study visit worthwhile without interpreter: **2.5**
7) The duration of the study tour was just right:**2.75**
8) The presentation were relavant: **3.25**
9) The presentation were good quality: **3.5**
10) There was enough opportunity for Questions & Answers: **3.5**

8. **Qualitative: reflection and comments**

Summary comments delegates

- The delegation would prefer to have in-depth learning sessions on specific topics that are directly relevant to their work.
- Field visit should be improved by providing more time for discussion after the visit in order to summarize lesion learnt
- Better selection of the site to visit
- The next study tour should be on supervision of leasing company

9. **Conclusion, lessons learned/recommendation**

- The 3rd study tour to Indonesia has been completed as planned; however, the outcome of the visit does not meet the original objective, due to the change of target participants. Therefore, the participant's refection above is something different.
- It is difficult to organize a study visit for high level of management team due to time constraint and urgencies of the work.
- Lack of TA admin support staff, instead rely on BOL/IRD staff support. This leads to some confusion because of the staff workload.
- For next study-tours it is most clear that one of the important requirement for the participants is English proficiency, in case no interpreter: the lowest and most significant score of only 2.5 on the question of English proficiency, on the other hand a score of 4.75 on overall usefulness of the study-tour and knowledge gained of the average scores are between 3.0 and 3.75

Annex

Translation of debriefing report on the study tour, written by the delegation leader Mr. Bouanguern Phongsavath, Managing Director APB

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity
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Agriculture Promotion Bank Ref. 147/APB
Vientiane Capital, 4 August 2011

To: Governor of the Bank of the Lao PDR
Sub: Report on the results of study tour to Indonesia on the topic of "Enhancing Financial sector supervision"-TA 7500

Based on the agreement Ref No. 531/BOL, dated 1 august 2011 regarding the assignment for our bank staff to participate in the study tour in Indonesia.

VI. Delegations Members

5. Mr. Bouanguen Phongsavath, Managing Director ABP
6. Ms. Manosin Tandavong, Head of the division, FISD BOL
7. Ms. Valasin Dalaphone, Technical staff, FISD BOL
8. Ms. Avila Khounnavong, Technical staff, IRD BOL

We would like to report the result of the study tour to Indonesia under the topic "Enhancing Financial sector supervision" from 09-16 July 2011.

1. General information:

Indonesia is a country with a capital city named Jakarta. The country consists of 17,508 islands and the total territory is 5,455,2 km^2 , land is 1,910,3 km^2, sea 3,544,743,9 km^2 . Total population is 237,6 million, average life expectancy is 70,9 years. The majority of the population is Islamic and Hindu. The country is divided into 33 provinces and 77,012 villages. There is two seasons, dry and raining, temperature 13-38^{0}c

VII. Contents of the Study Tour

8. Activities of the study tour

The study tour to Indonesia under the topic "Enhancing Financial sector supervision" to visit the Central bank of Indonesia and BRI 11-15 July 2011 can be summarize as follows:

- **In Jakarta**

Morning 11 July 2011 visit Central Bank of Indonesia, we receive warm welcome from management of the bank and then listen to the brief report regarding situation of bank supervision and financial institution in Indonesia after that question and answer session. The Central Bank of Indonesia does not directly supervise financial institutions; this role is delegated to certain commercial bank and the assigned commercial bank regularly report to the central bank. The main legal tools used for supervision is regulation timely issued by the central bank, there is no law. The discussion session was constructive and good learning from each other of the two parties. After the meeting at the central bank, at the afternoon 13:30 of same day delegation met at BRI to participate a workshop on supervision microfinance institutions, the workshop was organized by BRI Indonesia.

- **In Yogjarkarta:**

On 14 July 2011 the delegation travel to Yogyakarta and visit some sites of BRI. Yogarkarta is one of the province that plays important role in producing agriculture products, tourist and trading. Total population is 31 million. In Jogjakarta the delegation meet with management of BRI branch, brief report on supervision Microfinance institutions at Jogjakarta. There are 78 financial institutions under the supervision of this branch office. As reported in May 2010 NPL rate is 2.04% of the total loan outstanding of 7,035 million Indonesian Rupi.

VIII. Compare the lesion learnt with our/Lao practice

1. Lesion learnt from the study visit:

In Indonesia supervision of and licensing of the microfinance institutions are done by a commercial bank BRI but not the central bank. The tools and regulations timely provided by the central bank. The central bank has macro supervising role with commercial banks. Regarding the supervision of other kind of financial institutions such as pawn shops in Indonesia there is no legal supervision in place and also no plan for the near future to regulate this business.

From the discussion we learnt that BRI is one of the largest commercial bank of Indonesia was established in 1984. It has its own branches all over the country. The bank has its rich experience in supervising microfinance institution as the supervision model is the commercial bank supervising microfinance institution using tools and regulation issued by the central bank. The microfinance, non-bank financial, network institutions regularly report progress of their operation to BRI. The operation of BRI is as follows:

- 422 branches, 471 agents and 617 service unit
- The banks provides e banking service
- 4,861 ATMs machines
- 12,615 EDC machines

For supervising financial institution BRI use online BIMAS program. It is quite an advanced program. The bank can be online with the financial institutions by using the program. The bank can be online and access the system such as accounting, loans, and other services of the MFIs, the BIMAS program can check and waning MFIs. BRI will communicate immediately with MFIs when see the waning of BIMAS, problems arise. The BRI also conduct regular on-site examination with MFIs in a six months basis. Online checking is conducted in a monthly basis.

- **Lao practice**

The central bank has macro supervision role and directly supervise financial institutions and commercial banks and issues regulation for supervising them which different from supervision of MF in Indonesia. The Financial Institution Supervision Department (FISD) was recently established, August 2010, therefore there are many thing need to be improve such as human resource, legal framework and to update the IT system for effective supervision of financial institutions

IX. Recommendations

For effectiveness of supervision financial institutions and to ensure smoothly implementation of the policies and regulations and modernize reporting system and online supervision to ensure regular and effective supervision, the team propose the following:

1. Continuous capacity building for staff at FISD, especially on FINA program, by sending them to training abroad, to improve MIS system, to learn from the countries that use the same program FINA, with similar supervision model. In order to upgrade the supervision capacity in line with the role and responsibility and meet international standard.
2. The next training /exposure visit more time is recommended, at least two weeks. There are many thing to be learnt at the workshop but time was too short, and too rush. Therefore, we could not learn much.

Therefore, we submit this report to you for your information and for your direction.

Sincerely,

Bouanguern Phongsavath
Director, APB

Sent to:

10. Governor of the Bank of Lao PDR
11. Deputy Governor of the Bank of Lao PDR (Supervisor for Financial Institutions)
12. Personnel and Organization Department
13. International Relations Department
14. Financial Institution Supervision Department

Appendix 4. Evaluation Study Tour no. 4 to Malaysia

TA 7500-LAO: Enhancing Financial Sector Supervision

Component 2

Evaluation Report

Study tour to Malaysia, 31 October-4 November 2011

Prepared for the Asian Development Bank, Southeast Asia Department

By Vanhsy Chindavong

National Microfinance Specialist/consultant

December 2011

Executive summary

As part of the activities under component 2 of the ADB TA-LAO 7500 aiming to enhance the capacity of the Bank of Lao PDR (BOL) to supervise the Rural and Microfinance sector in the Lao PDR, 4 study tours have been organized. The last study tour to Malaysia.

Four senior staff from Legal division, Financial Institution Supervision Department (FISD), BOL participate training “ACCESS TO FINANCIAL SERVICES FOR THE MICRO, SMALL & MEDIUM ENTERPRISE SECTOR” organized by the central bank of Malaysia, 31 October to 3 November 2011, SasanaKiyang, Kuala Lumpur.

The program was intended for policymakers at middle to senior management levels involved in developing access to financial services to create a more inclusive financial system. The expectation of the participants was to learn more about supervision financial institutions, especially legal aspect. The training objectives were not much matched the participants’ expectations. However, the participants expressed that the training increased their knowledge and long term important to their work indicated by an average score of 4.25 given by the delegation members, when a 5 score would have been the maximum. But it is not relevant to their current work and low level of English proficiency among the participants; these both areas have significant low score of 2.75. This due to the training is ready made design by the central bank of Malaysia for all countries and regions. It is not a tailor made for specific country. However, the study tour was satisfactory with overall score of the study tour is 3.58 out of 5.

2. Introduction

Background: The program is relevant for policymakers for financial sector development, development finance, financial education for businesses and promotion of MSME industries. This program aimed to share with participants, Malaysia's experience in the development of MSMEs and provide participants with an understanding on how public policy can assist MSMEs to become more productive. In particular participants were given an insight into the important issue of financing for MSMEs, from policy development, products and services and infrastructure to sustainability of access to financial services by MSMEs.
This comprehensive program provides a platform to discuss on key aspects of financial services for the MSME sector. Key topics include:

- An overview of policy development and coordination for the MSME sector from the regulatory and capacity building perspectives
- Financial products and services to support MSME
- Innovations in delivery channels for the MSME sector
- Infrastructure support for access to finance by the MSME sector including credit guarantees, credit risk reporting, financial inclusion measurement and data for policy design and credit information
- The role of market conduct regulations and financial education for consumer protection and sustainability of credit

3. **Objective:** The original learning objectives and expectation of the BOL delegation are as follows:
    - To learn from the BNM's methodologies and experience in supervision of financial institutions (FIs), including microfinance providers, pawn shops, leasing companies and money transfer companies.
    - To learn about specific created procedures for supervision: the supervision manuals, licensing procedures, Chart of Accounts and reporting formats for all different types of FIs

4. **Participants**: There were 4 senior staff from legal division, FISD, BOL participated the training:
    1) Ms Keasorn Manivong, Deputy Director General, FISD
    2) Ms Phedsamone Chandara, Head of Division, Legal Division
    3) Ms Phaiphet Chounlamountry, senior staff, Legal Division
    4) Ms Bouathong Khensabab senior staff, Legal Division

5. Training program outline:

DAY 1: Monday, 31 October 2011

Macro Perspective

- Enhancing the Capacity of SMEs to Participate in the Economy, SMECorp, Malaysia
- Access to MSME Financial Services – The Malaysian Experience, Development Finance Enterprise Department, Bank Negara Malaysia

MSME Products

- Commercial Microfinancing
- Microfinancing via Cooperatives, Bank Rakyat (TBC)

- Financing for Start-ups

DAY 2 : Tuesday, 1 November 2011
MSME Products (continued)

- Financial Services for Small and Medium Enterprises, Public Bank Bhd

Channels and Institution

- Banking Beyond Branches, Maybank Bhd
- Bank Simpanan Nasional – Transformation from Deposit Mobilisation to Full-fledged Microfinance, Bank Simpanan Nasional

Infrastructure to Support Access to Finance

- Credit Guarantee for Small and Medium Enterprises, Credit Guarantee Corporation, Malaysia
- Regulation of Development Financial Institutions, Development Finance and Enterprise Department, Bank Negara Malaysia
- Credit Bureau Services to Support MSMEs Access to Finance, Credit Bureau Malaysia
- Financial Inclusion Measurement and Data for Policy Design, Development Finance Enterprise Department, Bank Negara Malaysia and member of the AFI Data Working Group for Financial Inclusion
- Making Available Quality Credit Information, Financial Surveillance Department, Bank Negara Malaysia

DAY 3 : Wednesday, 2 November 2011
Infrastructure for Education, Protection and Re-dress
Consumer Protection and Sustainability of Credit

- Consumer Protection and Ensuring Sustainability, Consumer & Market Conduct Department, BNM
- Financial Education for Better Credit Management, Credit Counseling and Debt Management Agency (AKPK)
- Advisory Services and Avenues to Seek Assistance, BNM LINK
- KL Experience

(More detail see the attached training program)

Evaluation

6. **The evaluation of the study-tour**. The evaluation only can assess overall success of the study tour. The overall evaluation use a score from 1 to 5, based on the average of all four delegation members, where a 1 indicates the delegation completely not agrees and a 5 score means the delegation fully agrees.

7. **Quantitative: scoring**
The scoring system is based on the average of the individual scores given by the delegation members on a scale where a score of **1** means fully **not agree** and **5** score means fully **agree,** average score is **3.58**. The scores are as follows:

Overall Evaluation

11) The study tour was useful**: 3.5**
12) The study tour has improved my knowledge: **4.0**

13) The knowledge I have acquired from the study tour is of relevance to my work: **2.75**
14) The knowledge I have acquired from the study tour is immediately applicable in daily practice of my work: **3.0**
15) The knowledge I have acquired from the study tour is of long-term strategic importance to my work: **4.25**
16) I understand enough English do make the study visit worthwhile without interpreter: **2.75**
17) The duration of the study tour was just right: **2.75**
18) The presentation were relevant: **4.0**
19) The presentation were good quality: **4.0**
20) There was enough opportunity for Questions & Answers: **3.5**

8. Qualitative: reflection and comments

Summary comments delegates

1) The training was useful, it would be more useful if it is directly related to our current work
2) My knowledge about MSMEs increased
3) Leant about Malaysia experience on MSMEs
4) There are some topics are not applicable and not relevant to current work because not related to licensing and legal matter as expected.
5) There are some topics are applicable to current work
6) Knowledge acquired from the training can be long-term importance when the microfinance in Lao more developed.
7) English proficiency is not adequate to fully understand all the presentation with time pressure, rushing difficult to catch up.
8) Time is right for presentation but not sufficient for question and answer session
9) The presentations
10) The training quality was good

9. Conclusion, lessons learned/recommendation

- In the future should conduct a study visit tailored to real needs of the participants and relevant this to ensure the knowledge acquired from the visit is applicable in order to improved supervision efficiency.
- The study tour is increased knowledge of the participant, but not relevant and not applicable for their current work and the knowledge would be useful in the future when MSMEs more mature stage.
- The presentations with high quality and professional.
- It is clear that the study tour is useful but not relevant and low level of English proficiency among the participants; these both areas have significant low score of **2.75,** overall score of the study tour is **3.58** out of **5**. The study tour is satisfactory.

Annex

Translation of report on the study tour, prepared by the participants

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity
****

Bank of Lao PDR — Ref… /FISD
Financial Institution Supervision Department — Vientiane Capital, ……December 2011

To: Governor of the Bank of the Lao PDR
Sub: Report on participated training "ACCESS TO FINANCIAL SERVICES FOR THE MICRO, SMALL & MEDIUM ENTERPRISE SECTOR", Malaysia

- Based on the agreement Ref No. 930/BOL, dated 18 October 2011 regarding nomination of staff to participate training in Malaysia.

We, technical team from FISD are pleased to report you about the training that we participated, topic of the training "ACCESS TO FINANCIAL SERVICES FOR THE MICRO, SMALL & MEDIUM ENTERPRISE (MSME) SECTOR", which was organized by the central bank of Malaysia, 31 October-3 November 2011. There were 22 participants, who supervise MSME sector from Central Bank of 7countries such as Cambodia, Laos, Nepal, Tanzania, Indonesia, Yemen and Sudan. Detail of the training as follows:

1. **Objective of the training**
   - To learn about Malaysia experience on MSME sector development
   - To enhance understanding of staff medium and higher level about improvement of access to financial services and conducive legal environment for MSMEs, including regulations, products, service and infrastructure for viable access to MSMEs
   - To share with practitioners and supervision organization, Central Bank of Malaysia about regulation development and cooperation for MSMEs, financial products and services to promote MSMEs, infrastructure for better access to MSMEs e.g. loan guarantee, report on credit risk, financial support including measure and information for regulation development and credit information, consumer protection

2. **Contents**

   It was 4 days training course, consists of 5 main sessions, 16 presentations. Visit to BNM LINK Central Bank of Malaysia and AIM Enterprise. Details are as follows:
   Session 1. Macro Perspective

Topic 1: Enhancing the Capacity of SMEs to participate in the Economy presented by SMECorp, Malaysia.

Topic 2: Access to MSME Financial Services

2.2 MSME Products

Topic 1: United Overseas Bank (Malaysia) Bhd. Subsidiary of UOB Singapore (estb 1935).

- UOB core business is SME banking; about 24%.
- Historically, UOB has always been located in the main commercial area where the retail business is active; e.g. wet markets, trader bazaars, retailers and wholesalers.
- Huge potential in microfinance due to its great demand.
- Government supported segment – lower funding cost, low insurance premium, good media coverage etc.

Topic 2 : Brief information on Commercial & SMI Financing for Cooperative offered by Bank Rakyat, manager, SMI Financing Department: bank Rakyat

Topic 3 : Catalyzing Sustainable Technopreneur Cradle, Cradle Funds Technology Innovation with Commercial Value, focus on technology related, innovation, commercial viability

2.3 Channel and Institutions

The presentation was done by national Saving Bank. Introducing services of the bank which include saving, credit, Credit and Debit Cards, ATM, payments, money transfer including transfert rough mobile phone. Challenges: outreach still limited, high operating cost, entrepreneurs have limited marketing data, technology, access to funding resources no collateral, no business plan, repayment problem etc.- The services provided through e-banking to attract group of young customers, promotion advertising through TV channels, printings to ensure the information reach more people in remote areas.

2.4. Infrastructure to Support Access to Finance

This session focused on guarantee schemes, credit information to support access to finance of MSMEs. the Credit Guarantee Schemes for SMEs in Malaysia, Credit Guarantee Corporation (CGC) is owned by Central Bank of Malaysia. Central Bank holds 78.65% of total shares and 21.35% of the shares owned by other institutions. The administration income of the corporation is from guarantee fees, from investors such as financial institutions, and collection fees from the. CREDIT BUREAU MALAYSIA (Formerly known as SME Credit Bureau (M) Sdn Bhd), Credit Bureau Services to

Support MSMEs Access to Financing. A Strategic Partnership between Credit Guarantee Corporation Malaysia Bhd. (CGC), Dun & Bradstreet Malaysia Sdn. Bhd. (D&B) and the Association of Banks (ABM) in Malaysia. An online database of credit information on borrowers, obtained from members of the bureau, public databases and other external databases. It is a convenient one stop centre for financial institutions and businesses to retrieve credit information and ratings on SMEs for credit evaluation purposes. A platform for SMEs and micro-businesses/individuals to build track record and credit standing by having positive credit files.

2.5. Consumer Protection and Sustainability of Credit

The presentations in this session were done by Central Bank of Malaysia such as on financial sector assessment which presented by the manager of credit consultation and debt management which was established in 2006 under the central bank. The objective is to provide consultation on credit and debt management and financial education for youth at school, working adults, women etc. The other presentation was from BNM LINK was established in 2005 by Prime-minister, currently there are 5 branches. This center provides consultation and advice on financial issues, provide financial information and disseminate this information to local authority.

Day 4 the delegation visited AIM, which established in 1987 as international non-profit organization. The objective of the institution is to help pour households by providing microloans Grameen bank model, lending to poor women. After that visited costomers-borrowers activities at the field.

3. Lesson learnt.

1) In Malaysia there is a Board of MSMEs development established and approved roles and responsibilities of financial institutions in 2006. The objective is to increase access to finance of the Micro-entrepreneurs by supporting sustainable finance.
2) The central bank of Malaysia has established credit consultation and debt management unit. The main activities of the unit provides financial education to public, consultation, debt management, provide financial data.

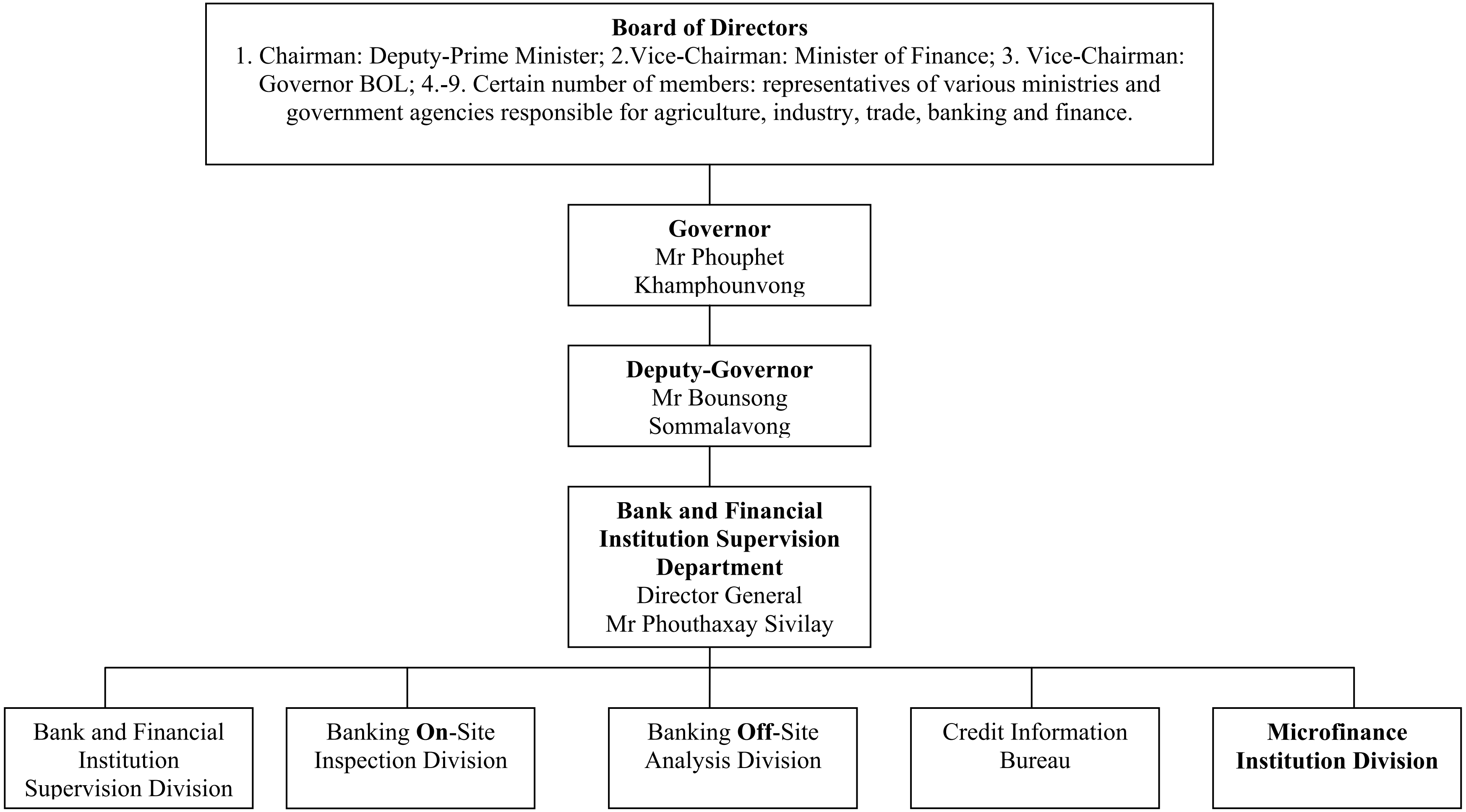
4. Recommendation

1) Financial education to public is very important. Therefore, the central bank of Malaysia established credit consultation and debt management unit with free of charge service experience is to support this purpose. For Lao PDR not yet discuss about this issue, it is new to the country, however, it is worthwhile to think about and prepare for that. The World Bank is interested in this issue, therefore, it might be a possible funding source
2) BNM LINK of Malaysia central bank which involved many stakeholders, one of them is credit consultation and debt management unit. This center plays as a financial information center, provide financial advice to general population. In the future, BOL policy making body should have further communication to share experience regarding the matter.

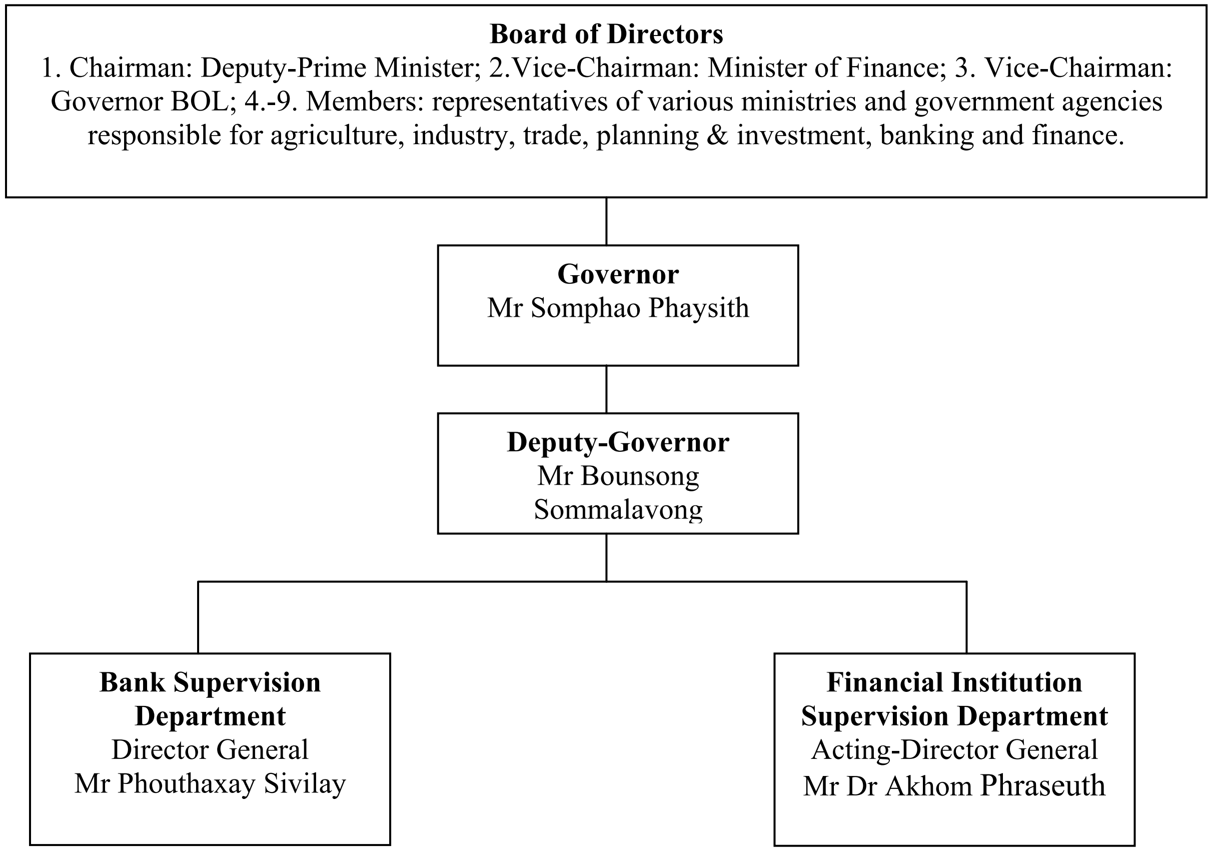
CC :

- Mr. Bounsong Sommalavong, deputy governor
- Personnel department
- Cabinet of MOFA
- FISD, BOL
- ADB TA 7500-LAO

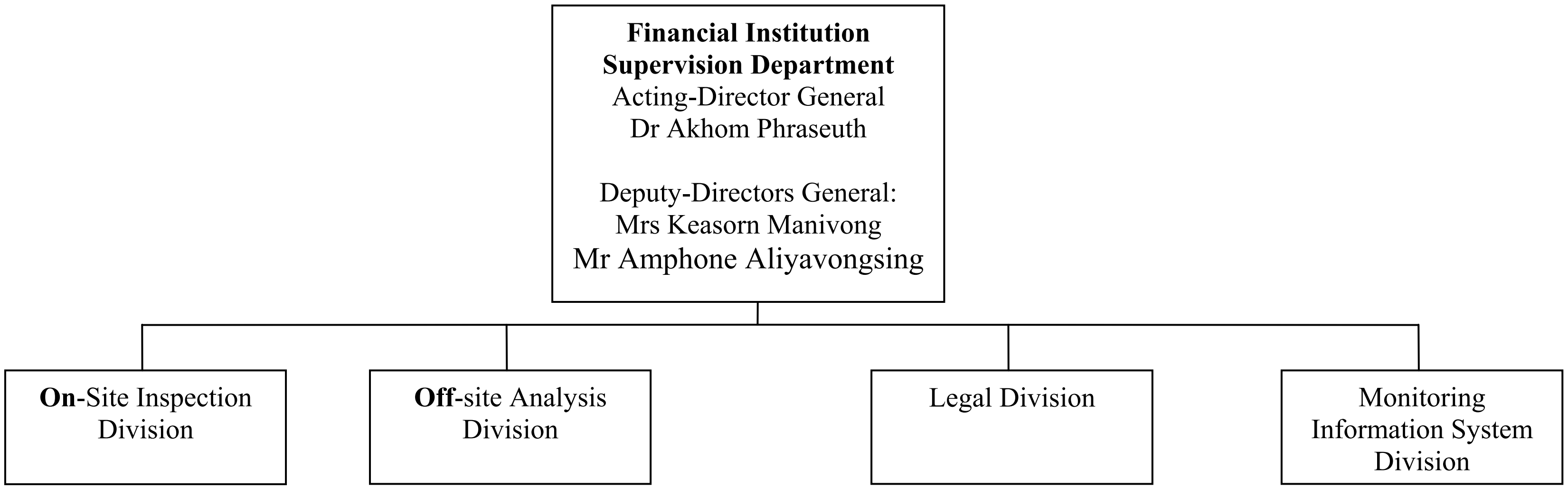
Appendix 5. Microfinance Institution division (situation before 27 August 2010)



Appendix 6. Financial Institution Supervision Department (situation starting 27 August 2010)



Appendix 7. Financial Institution Supervision Department and its four divisions



Appendix 8. FISD overview of recent training and TA (2011)

MAFIPP/UNCDF

No.	Topics	Date	Staff	Provider Training
1.	MF Accounting and On-Site Examination including On-Site Examination on the job training)	24 Oct - 01Dec 2011	20 including 8 staffs from branches and 3 experience staffs	EBIT
2.	English	Whole year	10 staffs	Vientiane College

AFP/GIZ

No.	Topics	Date	Staff	Provider Training
1.	MFI Program	14 Mar 2011	1 experience	AFP/Khaka
2.	Supervision Financial institution (Off-Site Examination, On-Site Examination, FINA)	11-29 Jul 2011	Total 31staffs including 9 from branches, 3 from Banking Institute and 16 experience staffs	George and Khaka
3.	On-Site Examination (On the job training)	31 Oct-5 Nov 2011	9 staffs including 4 staffs from branches and 1 new	George
4.	English	Whole year	5 staffs	Vientiane College

Others

No.	Topics	Date	Staff	Provider Training
1.	Loan Management organized by ACELEDA	14-18 Mar 2011	1 new	Woman Training Center
2.	Financial Crime Investigative	4-8 Apr 2011	1 Deputy Chief of Division	Satha Palace Hatel
3.	5th credit Union/Cooperative Regulators and CEO Workshop	24-29 Apr 2011	1 experience-deputy chief of division	ACCU/ Bangkok
4.	"Human Resource Management" and "Microfinance Management development Program" in Jakarta-Indonesia, organized by AMIDA & MICRA	19-25 May 2011	1 experience and Acting DG	Fund from MAFIPP
5.	Social Performance Management Organized by MFWG & supported by SEEP Globle Network, Plan International, Microfinance of the Phillippines and ADA	15-18 Aug 2011	2 staffs (1 experience)	
6.	Supervision Financial Institution-Hire Purchase Organized by Bank of Thailand	25 Aug 2011	5 experience	
7.	Seminar "Bond Market" Organized by Lao Securities Exchange	5 & 9 Oct 2011	2 experience	Nomura Research Institute
8.	Seminar "Corporate Bond Private Placement Regulatory framework" Organized by Lao Securities Exchange	27 Oct 2011	1 Experience	Nomura Research Institute

Appendix 9. Information on training and TA to MFId as part of ADB's CMP project.

Source: Final Report TA 9095, ADB CMP.

Table 4: Component A Outputs

Output	Achievement to 31 December 2010
1. Workshops conducted for MFI boards, management and staff in topics such as business planning, governance, accounting, information systems, credit assessment tools, and regulatory and reporting requirements.	*26 workshops conducted covering: business planning, management information systems / Microbanker, delinquency management, accounting, board governance, internal controls, credit management, office management, and human resource management.* *532 trainees participated* *Positive participant evaluations*
2. MFIs develop business plans that focus on best practice, sustainable outreach, and poverty reduction	19 business plans approved
3. Government officials and stakeholders with understanding of sustainable microfinance	160 government officials and stakeholders with raised awareness through workshop participation
4. Participating MFIs receive individual capacity building support	105 days of on-site technical support provided to 19 MFIs in 11 Provinces 33 days of institutional assessments (23 MFIs) and follow-up visits (16 MFIs) Positive evaluation reports
5. MFI staff gain exposure to MFI best practices through internships	28 MFI staff undertook internships Positive participant evaluations – 'most popular training activity' (highest scoring)
6. Workshops conducted for MFFMU/BOL staff in topics such as MF awareness raising, business planning, MF accounting computer training, as well as participation in regional MF conference	18 workshops conducted for BoL staff. 5 MFFMU staff trained
7. MFFMU staff able to manage grant fund and assess and monitor MFIs	5 MFFMU staff trained (5 training days plus continuous day-to-day coaching/ on-the-job training) • Positive evaluation reports • Capacity assessments conducted
8. Feasibility study conducted on potential for national APEX lending institution	Study conducted, report submitted

Table 11: BoL Training Evaluation Scores

Ref	MFI training topic	Average participant evaluation score (1=poor, 5=excellent)
1	MF Accounting Training	4.22
2	Risk Management Training	4.28
3	Microfinance Fund Management Training	4.50
4	MFI Institutional Assessment Training	4.43
5	Project Documentation/ Filing	4.33
6	M-Plan Training	4.49
7	MF Accounting Training	4.24
8	Off-Site Inspection	3.98
9	On-Site Inspection	3.92
10	MIS (MBWin) Training	3.80
11	MIS (MBWin) Training	3.78
12	Financial Analysis	3.66

Component 1	Microfinance Capacity Building, Training, and Outreach		
Project Objective 1:	To enable the staff of MFIs to develop the skills needed to become financially and institutionally sustainable; and create a supportive environment by building capacity of government and other stakeholders.		
Outputs	**Indicator**	**Achievements until Project End**	**Comments**
1.6 Workshops conducted for MFFMU/BOL staff in topics such as MF awareness raising, business planning, MF accounting computer training, as well as participation in regional MF conference	*5 MFFMU staff trained* *5 workshops*	5 MFFMU staff trained. Approx 40 BoL staff participated in project training. 18 workshops for BOL and MFFMU staff (73 training days)	
1.7 MFFMU staff able to manage grant fund and assess and monitor MFIs	*5 staff trained 10 training days* *Evaluation reports*; *Capacity assessment*	5 training days and constant on the job-training/coaching (approx 40 training days equivalent) Positive evaluation reports (score: 4.5) Capacity assessment conducted mid-term	*BoL did not complete an end of project capacity assessment*
Medium-term Outcomes	**Indicator**	**Means of Verification**	**Comments**
1A MFI staff demonstrate stronger capacity	*Consultant reports demonstrate improved capacity*	Consultant reports (per individual support visit) indicate improved capacity	
1B MFFMU better able to manage grants and support MFIs	*MFFMU capacity assessment report indicates improved capacity*	Positive capacity assessment report	

Appendix 10. Plan for training FISD on MFI supervision developed 2011 under Component 2.

FISD staff training outline

I. Background

The number of registered/licensed MFIs in the country is increasing in the last few years. This follows the greater needs of BOL supervisory capacity. To response to the growth of the sector, BOL is planning to share and delegate the responsible to it branches. Therefore, more staff training is crucial, in order to ensure effective supervision to the sector.

Recently BOL has proposed to reallocate budget (TA7500-LAO: Enhancing Financial Sector Supervision-Component 2) for more staff training (in the country) both at the central office and branches. This has been discussed during ADB mission

II. Objectives:

1. To enhance understanding of BOL branch offices staff about supervisory roles and responsibilities
2. To strengthen supervisory skills such as on-site, off-site examinations, microfinance accounting skills for off-site analysis.

III. Topics:

1. **Supervisory role and responsibilities of BOL**:
   - Role and responsibilities of FISD
   - Methods and process of the on-site examination
   - Financial analysis
   - Licensing procedures for establishment of financial institution, pawn shop, leasing company and international money transfer

2. **On-site examination** (combination of 50% theory and 50% practice/field work)
   - Standards of examination and report writing based on CAMEL analysis
   - Risk Based Examination:
     - Strategic Risks
     - Market Risk
     - Credit Risk
     - Liquidity Risk
     - Operational Risk
     - Risk Rating
   - Accounting Standard
   - Team work management

3. **Microfinance accounting** (classroom training with more practical exercises, guides and sharing)

IV. The participants/resource persons/time/venue

Topic	*# Participants*	*Training provider*	*Time/duration*	*Venue*
1. Supervisory role and responsibilities of BOL 1 For Northern branches & 1 Southern branches	10	FISD	4 days for each training, including traveling, June 2011	Luangprabang, Savannakhet
2. On-site examination	20: 9 from on-site examination division & other 11 from other divisions and branches	Consultancy company	10 days (5 days for theory and 5 days for practice/field work) June-July 2011	Vientiane Capital
3. Microfinance accounting	20: 9 from off-site examination division, other 11 from other divisions and branches	Consultancy company	5 days, classroom training, July-August 2011	Vientiane Capital

ADB
Asian Development Bank

Annex D. Closing Workshop TA-7500.

Workshop

Presentation of main results and findings:

ADB TA 7500: Enhancing Financial Sector Supervision

12th March 2012, Settha Palace Hotel

Agenda

Time	Activity / Presentation	Responsible / Speaker	Moderation/ MC
8.00-8.30	Registration	International Relations Department, BOL	
	Key Note Speeches		
8.30-8.35	Opening	Mr Phanthaboun Sayaphet	MC
8.35-8.45	Opening Remarks	Deputy Governor, BOL	
8.45-9.00	Introductory Remarks	Dr. Chong Chi Nai Country Director Lao Resident Mission, ADB	MC
9.00-10.00	Main results and findings component 1: Assessment of the financial sector and banking sector supervision	Mr Stephen Schuster Senior Financial Sector Specialist, Southeast Asia Department, ADB	Mr Stephen Schuster
10.00-11.15	Questions and Answers	All invited stakeholders	Mr Stephen Schuster
10.15-10.30	Coffee Break		MC
10.30-11.30	Preliminary findings component 3: Assessment of the anti-money laundering intelligence unit and supervision	Mr Stephen Schuster Senior Financial Sector Specialist, Southeast Asia Department, ADB	Mr Stephen Schuster
11.30-12.00	Questions and Answers	All invited stakeholders	Mr Stephen Schuster
12.00-13.30	lunch		MC
13.30-13.35	Opening afternoon session	Mr Phanthaboun Sayaphet	MC
13.35-13.50	Overview of component 2: The rural and microfinance sector supervision	Mr. Eiichi Sasaki Senior Financial Sector Specialist, Southeast Asia Department, ADB	Mr. Eiichi Sasaki
13.50-14.30	Main results and findings component 2: Assessment of the rural and microfinance sector	Mr. Timo Hogenhout International Microfinance Sector Specialist (consultant) Southeast Asia Department, ADB	Mr. Eiichi Sasaki
14.30-15.00	Questions and Answers	All invited stakeholders	Mr. Eiichi Sasaki
15.00-15.15	Coffee Break		MC
15.15-15.45	Presentation of main outcomes of study tours and trainings. as part of component 2	BOL representative	Mr. Eiichi Sasaki
15.45-16.15	Questions and answers	stakeholders	Mr. Eiichi Sasaki
16.15-16.30	Closing remarks	Deputy Governor, BOL	

Asian Development Bank

Closing Workshop

ADB TA 7500: Enhancing Financial Sector Supervision

12th March 2012, Settha Palace Hotel

List of Invitees

Ref.	Participant name	Position	Organization
1.	H.E. Sonexay Sitphaxay	Deputy Governor	Bank of Lao PDR
2.	Mr. Phouthaxay Sivilay	Director General of BSD	Bank of Lao PDR
3.	Mr. Akhom Praseuth	Director General of FISD	Bank of Lao PDR
4.	Mr. Phanthaboun Sayaphet	Deputy Director General of IRD and Director PSC	Bank of Lao PDR
5.	Mrs. Onechanh Saykhampheng	Deputy Director General of BSD and Deputy Director PSC	Bank of Lao PDR
6.	Mr. Khounesamay Vorarath	Deputy Director General of Personal Department and Member PSC	Bank of Lao PDR
7.	Mr. Leuane Vongphranakron	Director of AMLIU and Deputy Director PSC	Bank of Lao PDR
8.	Mrs. Khamking Phanthavong	Deputy Director General of BSD	Bank of Lao PDR
9.	Mr. Amphone Aliyavongsing	Deputy Director General of FISD and Member PSC	Bank of Lao PDR
10.	Mrs. Thipphavanh Chanthaphasouk	Deputy Director of BSD	Bank of Lao PDR
11.	Mr. Vongpraseuth Ratanavong	Deputy head of AMLIU and Chief of Sub PSC	Bank of Lao PDR
12.	Ms. Sengmamy Mamivong	Deputy Chief of Division, BSD	Bank of LAO PDR
13.	Mrs. Phothichanh Thammatheyva	Deputy Chief of Banking Supervision Division, BSD	Bank of Lao PDR
14.	Ms. Khamlar Heaunmanivong	Deputy Chief of On-site Division, BSD, Member sub PSC	Bank of Lao PDR
15.	Mrs. Siphachanh Khemmanivong	Deputy Chief of Division, Personnel Dept, Member sub PSC	Bank of Lao PDR
16.	Mr. Viengvilay Southichak	Deputy Chief of IFI Division, IRD	Bank of Lao PDR
17.	Mr. Manolith Soumphonphakdy	Secretary of Deputy Governor	Bank of Lao PDR
18.	Mrs. Chanhsouk Sisouphan	Deputy Chief of Off-site Division, BSD	Bank of Lao PDR
19.	Ms. Bouathong Khensabab	Officer FISD, Member Sub PSC	Bank of Lao PDR
20.	Mr. Chong Chi Nai	Country Director	ADB LRM
21.	Mr. Barend Frielink	Deputy Director	ADB LRM
22.	Mr. Eiichi Sasaki	Senior Financial Sector Specialist	ADB
23.	Mr. Stephen Schuster	Senior Financial Sector Specialist	ADB
24.	Mr. Phantouleth Louangraj	Economics Officer	ADB LRM
25.	Mr. Phounsouk Phoummanivong	National Consultant/Project Admin	ADB TA 7500
26.	Ms. Kelly Hattel	Financial Sector Specialist	ADB
27.	Ms. Marissa Ventura	Operations Analyst	ADB
28.	Mr. Timo H. Hogenhout	International Consultant	ADB TA 7500
29.	Ms. Avila Khounnavong	Officer, IRD	Bank of Lao PDR
30.	Mrs. Phetsamay Sidachanh	Deputy Managing Director of APB	Agriculture Promotion Bank
31.	Mr. Reynaldo Feria	Banking Advisor/Team Leader	Loan 2253
32.	Mr. Lattana Syhalath	Administrator/Banking Assistant	Loan 2253