Finanzgruppe
Sparkassenstiftung für
internationale Kooperation

"Village Banks (Village Savings and Credit Groups) in Vientiane Capital, Laos" – Roadmap Scenarios for a Sustainable Future

Bonner Schriftenreihe zur Entwicklungsfinanzierung Nr.4

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"Village Banks (Village Savings and Credit Groups) in Vientiane Capital, Laos" – Roadmap Scenarios for a Sustainable Future

by Prof. Dr. Hans Dieter Seibel

Revised, 29 March 2010

Financed by Bundesministerium für
wirtschaftliche Zusammenarbeit und Entwicklung (BMZ)

Federal Ministry
for Economic Cooperation
and Development

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Acronyms and abbreviations

ADRA	Adventist Development Relief Agency
BOL	Bank of Lao PDR
CARD MRI	Center for Agriculture and Rural Development Mutually Reinforcing Institutions
CPI	Committee for Planning and Investment (now MPI)
CODI	Community Organisational Development Institute, a Thai government agency
DID	Développement International Desjardins, Canada
DGRV	German Cooperative and Raiffeisen Confederation
DTMFI	Deposit-taking microfinance institution
EMI	Ekphatthana Microfinance Institution
FIAM	Foundation for Integrated Agriculture Management, a Thai NGO
GBA	Grameen Banking Approach
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit GmbH
LCSDPA	Lao Community Sustainable Development Promotion Association
LVCA	Lao Village Credit Association
LWU	Lao Women's Union
MCBR	Microfinance Capacity Building and Research Project
MFI	Microfinance Institution
MPI	Ministry for Planning and Investment
MFC	Microfinance Center
NDTMFI	Non-deposit-taking microfinance institution
NERI	National Economic Research Institute
SBFIC	Savings Banks Foundation for International Cooperation
RFSDP	Rural Finance Sector Development Program
SCU	Savings and credit union
SRDP	Small Rural Development Project
TYM-Fund	Tao Yeu May ("Mutual Affection Fund"), Vietnam Women's Union

UNDP/CDF	United Nations Development Program/Capital Development Fund
VB	Village bank
VC	Vientiane Capital
VSCG	Village Savings and Credit Groups
VWU	Vietnamese Women's Union
WCEP	Women and Community Empowering Project
WFDF	Women and Family Development Fund
WFP	World Food Program
WIDP	Women in Development Project

1. Introduction

The following study was commissioned by the Sparkassenstiftung für internationale Kooperation on behalf of the Lao Women's Union. This document provides information on the village banking system in Laos and analyses the various options open to village banks as part of the new microfinance regulatory framework.

In addition, the study aimed to support the Lao Women's Union in its efforts to obtain funding and technical assistance to implement the options presented for the further development of village banks in Lao PDR.

1.1 Microfinance terminology: what are MFIs to be called in Laos?

The term microfinance as introduced in the early 1990s refers to financial intermediation between low-income savers and borrowers without access to commercial banks. In Lao PDR, the policy statement on the development of sustainable rural microfinance defines microfinance 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".[1] Microfinance institutions (MFIs) are formal, semiformal or informal financial

1 Endorsed by the Prime Minister, PMO/1760, 17 December 2003. Recently the related action plan has been updated and approved. The objective is close to CGAP's definition: "Microfinance offers poor people access to basic financial services such as loans, savings, money transfer services and microinsurance. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks." (www.cgap.org).

intermediaries[2] providing both microsavings and microcredit and possibly other financial services.[3] In recent years the meaning of the term has sometimes been reduced to microcredit. Microfinance overlaps with more recent terms such as 'inclusive finance', denoting access to finance for all, particularly low-income people, and 'responsible finance', which is mostly seen from a commercial banking perspective. There is no agreement on what constitutes microsavings and microloans, which vary widely between countries and institutions, except that the amounts should be small, which is relative. Only a few countries have defined what they mean by 'microloan', among them Laos, which has set a ceiling of 10 million Kip ($1,175). Such a definition is best left to individual institutions, which can differ greatly from self-help groups to commercial banks.

Local microfinance institutions or activities in Laos come under many different names and guises. In the mid-1990s, UNDP/CDF (1996:28) used the term Lao Village Credit Associations (LVCA) But this should now be reserved for networks and organizations that fall under the September 2009 Decree on Associations that precludes funds registration. At the time, BOL, APRACA & GTZ (1997: 29) simply used the term microfinance but noted that it "consists mainly of credit components in projects of different donor agencies." In their own terminology, such projects promote credit groups, revolving fund groups, village revolving funds, village-based savings and credit societies, savings and credit societies or simply microfinance or rural financial services. The confusion between 'credit groups' and 'savings and credit groups' originally derived from the donor assumption that people in Laos are too poor to save and therefore need revolving funds. This was until it was realized that Laotians are eager to save, particularly women as the holders of the family purse strings. Credit groups have thus to varying degrees shown a tendency to evolve into savings and credit groups.

In Vientiane Capital village-based microfinance institutions have expanded over the last ten years and now extend across some 90% of all villages. Their main source of loanable funds are savings augmented by retained earnings;

2 Formal financial institutions fall under the regulation and supervision of the central bank (or other officially designated financial authority); semiformal financial institutions are otherwise officially recognized; other financial institutions, such as indigenous savings and credit groups, are informal financial institutions. From a central bank perspective both semiformal and informal financial institutions are nonformal.

3 According to CGAP (2008: xiii) "MFIs are defined as licensed and unlicensed financial institutions that include nongovernmental organizations, commercial banks, credit unions and cooperatives, and agricultural, development, and postal savings banks. They range from specialized microfinance providers to programs within larger, multipurpose development organizations."

there are virtually no external revolving funds. The promoters of these institutions refer to them as Village Savings and Credit Groups (VSCGs), a close translation from Lao. In the beginning, the term 'group' would have been more appropriate; but as permanent institutions with an average of 215 members, and a maximum of more than 1,000, the term 'group' is not appropriate.

In recent years the term 'village bank' has widely replaced other terms; it is now used by major donors like ADB, GTZ and ILO. Unfortunately this term is not appropriate either because these institutions are not banks in keeping with banking law. Indeed many would not even qualify as licensed MFIs. Yet given this widespread terminological practice, we have decided **to use the term 'village bank' in this study** for village-based MFIs. Relatively speaking, the term is more appropriate in Vientiane Capital than elsewhere in Laos, given the size, self-reliance and profitability of these institutions.

1.2 Objectives of the study

The population of six million people living in some 10,500 villages in Laos,[4] has access to an estimated 5,000 funds, each usually operating within a single village. The vast majority of them have resulted from donor initiatives over the past twenty years, almost all of them in close association with mass organizations – predominantly through the Lao Women's Union (LWU) – and local government agencies. These funds are semi-formal microfinance institutions (MFIs) ranging from purely donor-supported credit funds to fully savings-based financial intermediaries. Given the Lao people's pronounced drive to save, particularly among women as the holders of the family purse strings, many funds have built up substantial internal resources over time. According to a new microfinance regulation of June 2008, all microcredit and microfinance activities have to be registered with the Bank of Lao PDR (BOL), the central bank, regardless of size and outreach; the larger ones, with more than 200 million Kip ($23,600)[5] in voluntary savings, are required to become licensed as prudentially regulated MFIs.

The challenge to register (or license) is most pressing in Vientiane Capital, a municipality comprising some 500 villages in nine districts. Village-based microfinance institutions have been spreading fast in this municipality over the last ten years. And there are now about 450 village banks covering 91%

4 For key economic indicators see Annex 2.
5 Exchange rate as at 31 December 2009: 8,481 Kip to the US$ (reference rate of BOL).

of villages, all of them savings-based, almost 200 of them (43%) with more than 200 million Kip in savings. So far none has complied with the stipulation to register or has submitted a request for a license; nor has compliance been enforced. LWU, together with its technical partners, has played a prominent role in the establishment and promotion of village banks and is now concerned with their compliance and sustainability within the new regulatory environment.

Perhaps because the growth of village banking in Vientiane Capital has been quite recent, little is known about them. In fact the latest microfinance survey, carried out in 2006 *(see chapter 2.2)* did not contain any specific information about village banks in Vientiane Capital. The central bank and the village banks with their promoters occupy different places in the world of banking and finance, and there has been little, if any, communication between them.

The one-year grace period during which all village banks should have registered with the central bank expired in June 2009.

In this context the Sparkassenstiftung für internationale Kooperation (SBFIC), which has partnered LWU in the Women and Family Development Fund project and the Microfinance Center, a specialized training institution, since 2008, was asked by LWU to make recommendations for the future of village banks in Vientiane Capital. This led to the SBFIC proposal to conduct this study[6]. Besides complying with LWU's request, SBFIC assistance was intended to help LWU find a suitable way forward for the village banks in the long term. Prof. Dr. Seibel was in charge of this study. He was supported by Mr. Timo Hogenhout, Research work was carried out by Mr. Khanthone Phamuang.

The study has two major initial objectives:

- collect basic information about large village banks in Vientiane Capital;
- and more importantly, examine the various options village banks have within the framework of the new microfinance regulatory environment.

6 With support from the German Government (German Federal Ministry for Economic Cooperation and Development , BMZ).

To gather information, a survey was carried out in November 2009[7] covering a sample of 40 village banks with more than 500 million Kip in savings in Saithany District, most of them established between 1998 and 2003. Saithany is the district where savings-based village banks were first established in Vientiane Capital. Out of the municipality's nine districts, it is also the one that has most of the larger-scale village banks that are continuing to grow in outreach and size.

As the survey progressed, two sources of information were encountered that led the study to expand its objectives. One source presented itself during field work: a network comprising all village banks in Saithany District, with a network center housed, since February 2009, in a permanent office provided by the district administration. This, in turn, led to information[8] about similar emerging networks with monitoring and guidance functions in the other districts of Vientiane Capital. Additional objectives of the study thus include:

- presenting basic information about village banks in all districts of Vientiane Capital
- providing basic information about a networking structure in Saithany District as well as in the other districts
- assessing the emerging networks' potential to partner BOL in re-examining microfinance regulations, registering village banks, preparing village banks for licensing, and establishing a system of delegated supervision.

7 By a team from the CODI-supported *Women and Community Empowering Project (WCEP)*, including LWU staff working in the project and in the Saithany District network center. The team was headed by Khanthone Phamuang, who has been involved in the establishment and promotion of savings-based village banks *(Village Savings and Credit Groups)* in VIENTIANE CAPITAL from the outset.

8 Provided by Khanthone Phamuang, WCEP.

2. The operating environment of microfinance in Laos

2.1 The microfinance sector

Starting in the early 1990s when Lao PDR opened up and began evolving towards a market economy, multilateral and bilateral organizations supported the establishment of village-based credit schemes and revolving funds. Between 1994 and 1996 NGOs followed suit. By 1996 more than 20 organizations were involved in rural credit funds across all 17 provinces. Projects were implemented through district level administrations with LWU, agriculture and forestry services and other local government entities. Virtually all projects started with credit; over time many also got involved in savings. Villages are small in Laos, many with less than 100 families on average; thus, the emerging credit groups were correspondingly small, too.

With donor support, the number of credit schemes and revolving funds grew rapidly. According to a national survey by UNDP/CDF (1996), by mid-1996 their number had reached 1,640, with operations extending to about 15% of all villages. They included more than 1,000 rice banks, some livestock banks and revolving credit funds. Given the rural economy's low degree of monetization, most credit was in kind. All projects were carried out in cooperation with government organizations, particularly mass organizations whose outreach encompassed every village, e.g. the Lao Women's Union, the Department of Social Welfare and the Lao People's Revolutionary Youth Union (LPRYU). (UNDP/CDF 1996: 23) UNDP/CDF also compiled a list of donor-financed projects, albeit incomplete, with Lao Village Credit Associations, as they were called at that time. The list comprised 28 projects by 13 NGOs in 1,050 villages (CARE being the largest, covering 649 villages) and 9 projects by multilateral organizations in 518 villages (UNICEF being the largest, covering 489 villages). (Kunkel & Seibel 1997: 65)

The rapid growth in the number of village funds, their credit bias and donor dependency led to increasing concerns for their viability and sustainability. These concerns were articulated in particular by a Microfinance Roundtable, initiated and coordinated by UNDP/CDF, which had emerged as a lead organization in the microfinance debate. Three major microfinance conferences were held in 1995 and 1996[9] and from which two major concerns emerged: enhancing savings mobilization; and improving the regulatory environment for microfinance services. (UNDP/CDF 1996: 63)

These issues were subsequently taken up by a national consultation workshop in March 1997[10], which concluded that,

Laos needs a well-functioning system of microfinance with viable institutions and sustainable financial services for all segments of the population. There was consensus that such a system:

- should be savings-driven,
- comprise basic microsavings, microcredit and microinsurance services
- must be based on the cultural traditions of Laos in which women play a crucial role in microfinance; decisions must be reached with local level participation; and microfinance services must reinforce the existing networks of solidarity.
  (BOL, APRACA & GTZ 1997: 21)

FIAM and CODI. The development and implementation of a savings-driven approach toward the end of the 1990s – a new paradigm in Laos at the time – was spearheaded by two Thai organizations, both in cooperation with LWU. One was the Foundation for Integrated Agriculture Management (FIAM) with its Women in Development Project (WIDP) and Small Rural Development Project (SRDP) which took the lead in 1997 with an exposure program for LWU staff in Thailand. This was followed by the Community Organisational Development Institute (CODI) with its Women and Community Empowering Project (WCEP). The initial focus was on poverty alleviation in 20 villages.[11] In 1998 FIAM helped establish the

9 By GRETT, CCL, IRAM and BOL in October 1995, by UNDP/CDF in August 1996 and by UN-ESCAP during the same month.

10 Jointly organized by BOL, APRACA and GTZ (1997).

11 Despite the proximity of the villages to the capital city, poverty was widespread. A survey by FIAM in 1997 showed that money was scarce, and the degree of monetization low. Some families had neither savings nor debts, others had debts of 50,000 to 200,000 Kip, some had savings up to 200,000 Kip. As reported by Khanthone, they lacked clean water, toilets and decent accommodation. Employment after the farming season was rare. The initial focal villages also lacked an irrigation system.

first savings-based village banks, or village savings and credit groups (VSCG), in Saithany District , expanding in 2002 also to Saysettha District, both in Vientiane Capital. This was followed by CODI as of 2002 in the remaining seven districts of Vientiane Capital, and subsequently also in 15 districts in four other provinces[12].

Self-financing, self-management and self-governance were not only the basic principles of the village banks promoted by FIAM and CODI; these principles were also extended to a secondary level of network associations, comprising all village banks within a district (described in greater detail in *chapter 4)*. This approach became a model for LWU and other organizations with their partners throughout the country. A growing savings component is now widespread in schemes which started out as revolving funds, all in response to a strong urge to save among the Lao population. FIAM and CODI provide technical assistance. Except for a small grant in 1997, there have been no donor credit lines or capital grants, neither to the village banks nor to the district associations which has thus fostered self-reliance and self-determination. Most replications by other donors differ in this respect by tending to provide seed capital or credit lines or even part of the running costs. The savings portfolio of the village banks under FIAM and CODI almost matches their loan portfolio, which is fully financed from savings and income from interest and penalties *(Chapter 3, Tables 9 and 14)*. In contrast, in the village banks supported by ILO and GTZ, the percentage of the outstanding loan portfolio financed from savings is 73% and 47%[13] respectively. In the national survey by NERI, the share of savings is 47% of the loan portfolio, which indicates, on the one hand, that savings have indeed become a major source of loanable funds and, on the other, that external resources are still an equally strong source of funds.

ADB has played a prominent role in Lao financial-sector development. Its emphasis has been on the formal sector and included banks and MFIs. With hardware and training, its Banking Sector Reform Program has been helping to build up capacity in state-owned banks since 2003, whilst its Rural Finance Sector Development Program (RFSDP) has facilitated the transformation of the Agricultural Promotion Bank, a provider of rural microfinance, from a loss-making policy bank into a commercial bank.[14] In microfinance ADB focuses on

12 Four districts in Luang Prabang, three districts in Champassak, three districts in Bokeo and five districts in Phongsaly. The total number of village banks promoted by CODI in Vientiane Capital and in four provinces is 471, among them 122 with more than 200 million Kip in savings. (Kanthone 2010)

13 In the case of GTZ, the 47% includes a substantial subsidy as an incentive to save.

14 ADB is now worried about the banking sector's inflated growth not being matched by corresponding growth in the real economy, as this poses a threat to bank reforms.

the policy framework for the transformation of MFIs into regulated institutions and on strengthening such institutions as a poverty reduction mechanism. ADB has completed its regulation project, which included the preparation of three regulations together with the related chart of accounts, and the creation and strengthening of the Microfinance Division in BOL. In the ongoing *Catalyzing Microfinance for the Poor* project, ADB started by strengthening a selected number of the total of 11 MFIs that were already in existence. In a second phase, it now supports 18 out of 27 MFIs: 11 licensed as SCUs, 5 licensed as DTMFIs and 8 registered as NDTMFIs. The two main instruments of support are capacity-building and the provision of matching grants. Capacity-building includes the development of training materials for the Laotian context; a train-the-trainers course in business planning; a course on awareness-raising, accounting and delinquency management using CGAP training materials; and accounting training with MFC. Matching equity grants between $3,000 and $50,000 per MFI are provided, mostly in 3 tranches over a three-year period, but not more than $25,000 per year. The MFIs' own contribution comprises equity and savings. So far ADB found that the absorptive capacity for matching grants is greatest among profit-oriented DTMFIs funded by private shareholders. But overall the capacity of the selected MFIs to mobilize own resources was found to be limited; perhaps only about half of the $800,000 earmarked for matching grants may in fact be invested. In 2009 ADB also examined the feasibility of an apex microfinance fund, concluding that, given the small number and scale of qualified regulated MFIs, there would be no scope for such an apex institution within the next five years.[15]

ILO. ILO and the Stone Family Foundation provide technical assistance through LCSDPA to a total of 139 village banks in four provinces; in addition, 80 village banks have received seed capital. The project started in 2003 with SME training and a revolving fund concept. In 2004 it adopted the FIAM approach of savings-based village banks. ILO has developed training materials in English and Lao that are adapted to the Laotian context. Two books have been published under the title *Village Banking in Lao PDR (2008)*, one a *Handbook for Village Bank Management Committees and Support Organizations*, the other a *Ledger Guide*. The village banks are assisted and monitored by the Lao Community Sustainable Development Promotion Association (LCSDPA), a FIAM's successor organization. LCSDPA plans to establish a network system in all four provinces similar to the one in Vientiane Capital, but ILO has been reluctant to support this. Instead, ILO will now focus on transforming a select number of

15 The core challenge is a shortage of human resources and technical assistance, not financial resources.

village banks into regulated and licensed institutions. Applying BOL regulatory criteria, ILO found that 13 village banks would qualify as SCUs, two as DTMFIs and one as either SCU or DTMFI. We may assume that the remaining 123 would have to be registered as NDTMFIs. Piloting is to start in six villages.

GTZ. In the framework of its Rural Development in Mountainous Areas (RDMA) project, GTZ has built 181 village banks in three provinces in Northern Laos. GTZ is in the process of building village bank associations with sustainable support services for their member institutions. Licensing village banks or their associations has met with difficulty, since the regulation fits neither. So far, of the five existing networks only one – the Hongsa-Nguen Community Credit and Saving Association (CCSA) – has been registered as a NDTMFI; another – the Khop CCSA – has a tax and business license, but is not yet registered with BOL.

SBFIC is taking a different approach. It neither works through village banks nor with an individual technology. In partnership with LWU and CARD[16] as a technical service provider and funded by the German Federal Ministry for Economic Cooperation and Development, it is in the process of establishing a *Women and Family Development Fund (WFDF)* as an MFI licensed to take deposits. Starting in October 2009, WFDF is testing a modified Grameen Banking Approach (GBA) that has previously been applied successfully in Vietnam with the Vietnamese Women's Union. Like the Grameen Bank in Bangladesh, WFDF is designed as a central institution operating through groups of 4-6 women, centers of 8-10 groups and branches with 20-25 centers, serving some 1000-1500 members per branch. In contrast to the Grameen Bank[17], which starts with credit, WFDF is a savings-based financial intermediary and operates on the principle of *savings first*. With a ratio of 80% voluntary to 20% mandatory savings during the start-up phase, total savings will soon dwarf the rotating credit fund provided by the project. Credit disbursement starts in January 2010. Having discovered that most families have various sources of small income, WFDF will also be testing the feasibility of weekly repayments during weekly center meetings. Grameen banking is strict about enforcing timely repayment, and CARD, the technical service provider with nearly one million active borrowers in the Philippines, has an on-time repayment rate of 99.6%.[18]

16 CARD MRI Rural Bank & NGO (Philippines), www.cardbankph.com/.

17 Actually the conventional Grameen I approach; Grameen II, which has been evolving since 2001, has a stronger savings orientation and focuses on individual loans.

18 CARD started in 1987 as a credit NGO with a revolving fund and 150 members. It almost folded up when its repayment rate dipped to 50%. When it adopted GBA and weekly meetings, the male members left, and the on-time repayment rate surged to nearly 100% where it has remained ever since. (Seibel & Torres 1999)

There is no doubt that adaptation of GBA from credit-first to savings-first will be successful in Laos. Yet more interesting will be another two aspects: (a) Will group lending be embraced in a country where individual lending has been the sole technology of the ubiquitous village banks? (b) Will members repay their installments on the day they are due as required by the system? That would be revolutionary in Laos – perhaps with far-reaching implications for other MFIs.

The MCBR/NERI survey. There are no reliable overall data on the microfinance sector. Since 2003, information on microfinance has been collected and disseminated by the Microfinance Capacity Building and Research Project (MCBR) under the supervision of the National Economic Research Institute (NERI), which is part of the Ministry of Planning and Investment (MPI). The project produced two annual reports on *Rural and Microfinance Statistics in Lao* based on postal surveys among district microfinance providers and projects. To improve data quality, the postal survey was replaced by sample field surveys in 2005 and, most recently, in 2006. NERI's involvement has been discontinued; a microfinance online resource center (www.microfinancelaopdr.org) established within MCBR/NERI to provide information about microfinance in Laos has not been updated for two years.

The most frequently quoted estimate of the number of microfinance institutions, including village banks and revolving funds, is 5,000. This translates into 50% of all villages in Laos. The latest sample survey by NERI (2007) in 2006 identified some 190 microfinance service providers at district level – 23% line government agencies, 37% projects and funds, 32% mass organizations and 7% Agricultural Promotion Bank (APB).

The most prominent partner organization is LWU, which accounts for 24% of all partnerships, followed by the Agriculture and Forestry Department (19%) and the Planning and Investment Department (12%) and the Lao Front for National Construction (12%). There is no list of service providers, most of which are active in several districts (like APB). The data are not broken down by provider, with the exception of APB as a single provider category. NERI identified microfinance activities involving 230,000 members[19] with 86 billion Kip in savings and 188 billion Kip in loans outstanding[20] – on average 50 members, 19 million Kip in savings and 49 million Kip in loans outstanding per village.

19 NERI lists involvement by providers in 4,664 villages; but the figures are duplicated since two or more providers may be active in the same village.

20 The late payment rate is given as 3.0%, which seems questionable.

In all, four major organizations with data for 2009 report on 915 village banks with about 154,000 members. Total assets amount to almost 200 billion Kip (US$ 23 million), total savings to 155 billion Kip (US$ 17.8 million) and total loans outstanding to 173 billion Kip (US$ 19.9 million). It is difficult to compare these data for 2009 with a wider sample by NERI of 2006. *(Table 1)*

Table 1: Selected data on village banks, 2009 (amounts in billion Kip)

	Starting date	Village banks	Members	Savings	Loans outstanding	Total assets
FIAM, VC (Saithany)	1998	107	34,946	52.07	62.08	62.49
FIAM, VC (Saysettha)*	2002	44	8,883	10.61	10.00	13.0
CODI, VC (7 districts)	2000	300	54,815	64.05	62.87	77.95
CODI, 4 provinces		144	15,089	9.56	10.74	11.91
ILO, 5 provinces	2003	139	25,517	16.62	22.87	24.97
GTZ, 3 provinces	2006	181	14,394	2.18	4.66	5.99
Total		915	153,644	155.09	173.22	196.31
NERI survey in 2006		4,664	229,579	86.15	188.01	193.82

* Loans outstanding and total assets extrapolated.

Regulated MFIs. By the end of 2009, almost half a year after the registration deadline expired, only a fraction of the estimated 5,000 microfinance institutions had applied for BOL registration and licensing. There are now 16 licensed MFIs: 11 SCUs and 5 DTMFIs; five of them are located in Vientiane Capital. There is a major difference between SCUs and DTMFIs. Most SCUs reportedly have their origin in village banks and are member-controlled. In contrast, the DTMFIs are private and investor-driven (like Beer Lao as one of the investors) and under the control of major investors; small investors have little, if any, control. 8 institutions have registered as NDTMFIs, all with donor support. *(Table 2)*

Table 2: Microfinance institutions registered with BOL, November 2009

No	Name	Province
Deposit-taking MFIs:		
1	Lao Postal Service Savings Institute	120 offices in Vientiane Capital and all provinces
2	Ekphattana DTMFI	Vientiane Capital
3	Newton DTMFI	Vientiane Capital, Vnt Prov. and Oudonsay
4	Saynyaisamphanh DTMFI	Savannakhet
5	Champa Lao DTMFI	Luang Phabang
Non-deposit-taking MFIs:		
1	Development Microfinance Institution Phongsaly	Phongsaly
2	Community Credit and Saving Association Hongsa-Nguenh	Sayabouli
3	Development Fund Association Bokeo	Bokeo

No	Name	Province
4	Community Credit and Saving Association Khop-Xienghon	Sayabouli
5	Oudomxay Development NDTMFI	Oudomxay
6	Suaykan Pattana NDTMFI	Huaphanh
7	Hom NDTMFI	Vientiane Province
8	Mimaity NDTMFI	Khammouane
Savings and Credit Unions:		
1	Rural Development Cooperative Naxaythong	Vientiane Capital
2	Credit Cooperative for the Support of Small Production Units	Vientiane Capital
3	SCU Vientiane	Vientiane Prov.
4	SCU Seno	Savannakhet
5	SCU Louang Prabang	Louang Prabang
6	SCU Thakhek	Khammouane
7	SCU Houamchay Phattana	Savannakhet
8	SCU Paksong	Savannakhet
9	SCU Huasae Chaleunouaxe	Champasak
10	SCU Thoulakhom	Vientiane Prov.
11	SCU Mittaphap	Vientiane Capital

Performance of regulated MFIs. Among eight MFIs[21] for which data are available (June 2009), four (50%) were found to be making a loss. Only 13% had a legally required portfolio-at-risk (PAR) ratio of <5%; 38% had a PAR <20%. The average PAR was 17% (excluding write-offs for loans overdue >180 days). The average gross portfolio size was 2.1 billion Kip; the average loss amounted to 8.8% of the portfolio. The contrast to the unregulated village banks studied in Vientiane Capital is striking. Have members of SCUs and shareholders of DTMFIs lost control (or they did not have control in the first place)?

Ekphattana Microfinance Institution (EMI), the oldest regulated MFI was established in 2005, and licensed in February 2006 as a DTMFI under the old, and in July 2009 under the new, regulation. Lending started in April 2006. As of 31 Dec 2009 total assets amounted to 6.8 billion Kip, loans outstanding to 2.75 billion Kip, savings to 3.8 billion and total equity to 0.78 billion Kip; losses amounted to -296 million Kip. PAR >30 days stood at 10.9%, requiring an increase in provisioning. According to the tax law, EMI pays 1% of its losses in taxes. It also reports that provisions are not fully recognized as expenses by the tax office.

EMI has five branches and a total staff (including management) of 43. It takes financial services to the client, providing daily, weekly and monthly collection services – an expensive technology. EMI pays 8% p.a. on compulsory savings

21 Two DTMFIs, five SCUs and Hongsa CCSA, a NDT MFI.

and 9% to 16% p.a. on term deposits (2% above commercial bank rates). Loan periods are 1-12 months. EMI charges 4% flat per month on loans from 0.5 million Kip to 9 million Kip (88.6% effective per annum, disregarding compulsory savings) and 4% p.m. on the declining balance on loans of more than 10 million Kip (48% effective p.a.). [22]

In EMI high losses and high interest rates come together. This is due to high transaction costs owing to the small loans, short loan periods and client-oriented collection services. For EMI to become sustainable, losses and interest rates will have to come down, whilst loan sizes will have to go up. This would run contrary to regulatory restrictions, requiring DTMFIs to hold at least 80% of their portfolio in microloans not exceeding ten million Kip ($1,175). EMI is still in its start-up phase. Since the end of 2008, ADB and SBFIC - through its partner CARD MRI – now provide technical assistance, ADB also provides financial assistance. All this is expected to boost EMI's viability. Any assessment of regulated MFIs' prospects for becoming viable and sustainable would have to be in-depth. It should be noted that, in a comparable situation (but on a quite different scale), in the late 1990s, the Grameen Bank found it necessary to fundamentally change its policy (Hulme 2008).

Naxaythong Rural Development Cooperative is a credit cooperative that has been profit-making since it first started. Licensed by BOL in 2001 on the basis of a BOL regulation on credit cooperatives issued in 1994 that is no longer valid, it was licensed again under a pilot SCU regulation in 2004. It has not yet received a license under the SCU regulation of 2008. According to DGRV, it is still unclear whether it should come under SCU or DTMFI regulation.[23] In 2001 Naxaython RDC started with 18 founding members, 386 ordinary share members and a total of 582 savers in 17 villages. By Dec. 2008, the number of shareholders had increased to 1,015 and the number of savers to 2,041 with 951 borrowers with a loan outstanding. Area coverage had also expanded to 52 villages. Total assets amounted to 2.61 billion Kip, loans outstanding to 2.14 billion, total savings to 1.99 billion and paid-up share capital to 0.30 billion. Net profit after taxes amounted 0.13 billion Kip. Some 0.12 billion Kip were distributed as dividends, which is equivalent to 6.1% of total savings.

22 By comparison, commercial banks charge 12% effective p.a. on large loans and 30% on small loans of 10 million Kip and above (e.g., ACLEDA Lao Ltd., a subsidiary of ACLEDA Bank Plc. in Cambodia, an NGO transformed into a microfinance commercial bank). By comparison, moneylenders reportedly charge 15% to 50% per month (180% to 600% eff. p.a.)

23 Adapting Naxaython to the new regulation is meeting with some resistance, as it requires changes to be made in the capital structure, since some members presently have more than the regulatory limit of 10% (Art. 5). The loan portfolio would also have to be amended, as some party loans exceed the limit of 5% of capital (Art. 44).

Naxaython RDC vs. EMI. SCU Naxaython's loan portfolio is not much smaller (17%) than that of EMI, yet it manages with a total staff of nine, compared with EMI's 43. Moreover, 82% of Naxaython's total assets are lent out to borrowers, compared with 59% in the case of EMI. These may be some of the factors contributing to the difference in profitability: 5.1% in the case of the Naxaython, -4.1% in the case of EMI (in terms of year-end total assets, 2008). Age alone does not explain this situation. Naxaython RDC has yielded a profit from the first year on, whilst EMI, which is now in its third year, has still not managed to do so. A deeper analysis is required to get the full picture.

2.2 The regulatory framework of microfinance

2.2.1 Background

The basic legal framework for Laos' financial sector was laid down in the early 1990s. BOL was created in 1990[24] as a central bank with licensing, supervision and prudential regulatory powers over financial institutions which were defined as legal persons doing banking or similar business. The framework for the regulation of financial institutions was laid down in 1992[25] and covered commercial banks and non-bank financial institutions. Non-banks were restricted from mobilizing funds from the general public and from issuing shares or bonds. BOL was empowered to make separate regulations for banks and non-banks. During the same year, a draft law on credit cooperatives was prepared but not enacted due to the negative experience with credit cooperatives and their collapse in the late 1980s.

By the mid-1990s the number of village funds had reached about 1,650. These were credit-based, unregulated and thus considered unsustainable. Initiatives in the mid-1990s led to a consensus on the need to promote sustainable microfinance institutions. Sustainability would require an emphasis on self-reliance through savings mobilization and a legal framework. In 1998, village savings and credit groups, or village banks, started emerging in the districts of Vientiane Capital that were fully self-reliant in terms of resource mobilization, with rapidly growing savings portfolios. By the mid-2000s, the number of village funds throughout Laos had surged to several thousand, many of them mobilizing savings. This increased the pressure to create a regulatory framework.

24 Law No 04/PSA of 27 June 1990.

25 Decree No. 3 of 23 January 1992.

Similarly, in the global microfinance community, due to rapid increases in number and size of MFIs, earlier resistance gave way to numerous regulatory initiatives for institutions variously named rural banks, MFIs, deposit-taking MFIs or savings and credit cooperatives. Yet, while authors like Christen & Rosenberg (2000:2) "believe strongly that the future of microfinance lies in a licensed setting, because it is the only setting that will permit massive, sustainable delivery of financial services to the poor", they also warned against a rush to regulate, "raising questions about timing, and about certain expectations that may turn out to be inflated." Much depends on whether regulation is simply imposed or the result of deliberation and communication between the regulator and the regulated – not always a cautionary and balanced process.

In 2004 a Microfinance Division was created under the Banking and Financial Institution Supervision Department of BOL. Its tasks: guidance, monitoring and supervision of the implementation of microfinance regulations. On 22 June 2005 BOL launched *its Regulation on the Establishment and Implementation of Microfinance Institutions in Lao PDR* (No.10/BOL), announcing that large microfinance institutions had to apply for licenses while smaller ones such as credit unions, cooperatives, saving and loan associations and village funds had to be registered, depending on their scale of operation. The first MFI that complied was Ekpatthana Microfinance Institution (EMI), which received its license in 2006.

2.2.2 The microfinance regulation of June 2008

Deliberations in various circles and conferences led to a notice by the Prime Minister on microfinance supervision in 2007[26], a proposal from the Banking and Financial Institutions Supervision Department of BOL and finally the announcement of three regulations, issued in June 2008:

- No. 02/BOL on Non-Deposit-taking Microfinance Institutions, of 20/06/2008 (EN)
- No. 03/BOL on Savings and Credit Unions, of 02/06/2008 (EN)
- No. 04/BOL on Deposit-taking MFIs, of 20/06/2008 (EN) (www.bol.gov.la/english/microfinanceeng.html)

There are two basic provisions in the regulation: the first pertaining to the universality of registration for any microfinance institution or activity, the second to the conditions under which they are to be licensed as prudentially regulated institutions:

26 No. 05/PM, dated 04 April 2007

- **Registration as NDTMFI:** Any organization, group or enterprise – governmental, non-governmental or private – that carries out microfinance activities, including village banks, savings groups, village funds, development funds and others, is required to register ***(Regulation No. 02/BOL Art. 3);***
- **Licensing as SCU or DTMFI:** Any microfinance entity with voluntary deposits exceeding 200 million Kip or annual revenues exceeding one billion Kip is required to be licensed as a prudentially regulated MFI, either a savings and credit union (SCU) or a deposit-taking microfinance institution (DTMFI) ***(Regulation No. 02/BOL Art. 20)***

All three types of MFIs are permitted to mobilize loans or grants from Laos as well as, with BOL approval, from foreign entities and to deposit funds with BOL or commercial banks. There are no interest rate restrictions. Penalties for non-compliance with the regulation can be imposed on any of the three types of MFIs, including managers or officers, individually or as a group.

To date compliance with registration and licensing requirements has not been enforced, even though the one-year grace period expired in July 2009. BOL seems prepared for further communication on the details of the regulation and is willing to accept an unspecified trial period, which may result in modifications to the regulation. This process is in line with the global realization in the context of the global financial crisis – not just microfinance! – that regulation is an evolutionary process subject to learning.

Non-deposit-taking MFIs (NDTMFIs) which do not exceed voluntary deposits of 200 million Kip or revenues of one billion Kip are required to register with BOL and relevant government authorities as so-called non-deposit-taking MFIs; there is no minimum size below which registration would not be required. Within this framework NDTMFIs are authorized to mobilize savings and grant microloans up to 10 million Kip. They have to apply BOL's provisioning rules and submit annual reports using BOL's chart of accounts. The highlights of the NDTMFI regulation are summarized in Table 3; an overview is given in *Annex 3*.

Table 3:
BOL regulation: Non-Deposit-Taking Microfinance Institutions – Summary

Requirement to register	Any and all microfinance activities by groups, individuals or legal entities
Required registrations	With BOL and relevant government authorities
Resource mobilization	Compulsory and voluntary deposits of members Loans or grants from Lao and foreign entities
Regulation	• Micro-loans only, not exceeding 10m Kip • Voluntary deposits not exceeding 200m Kip in aggregate and 10m Kip per depositor unless authorized by BOL • Quarterly review of all loans, provisioning as prescribed • Annual reporting to BOL
Requirement of conversion to a prudentially regulated MFI	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
Penalties for non-compliance	100,000 Kip per day to NDTMFIs incl. managers or officers individually or as a group

Source: www.bol.gov.la/english/mf_reg02eng.pdf

Bearing in mind that the regulation might be adjusted after a communication and learning period, some observations are in order:

- The term "non-deposit-taking MFI" is a misnomer as the regulation entails permission to mobilize voluntary deposits up to 200 million Kip.
- The deposit ceiling of 200 million Kip excludes compulsory deposits, which are defined as "a condition for receiving a loan or as collateral for a loan either as a percentage of the loan or as a nominal amount" (Art. 2). As no loans are given by village banks in Vientiane Capital without prior savings, the concept of compulsory deposits might be interpreted widely, which would lead to a substantial increase in the total amount of permissible deposits. The village banks in Vientiane Capital only list "savings" in their book, without distinguishing between compulsory and voluntary. To be on the safe side in legal terms, NDTMFIs might introduce both categories in their balance sheet.
- A wide variety of village funds, village banks, groups and other microfinance entities exists with widely differing operational practices which do not fit into one prescribed chart of accounts.
- There is no reference to taxation in the regulation; this falls under the Ministry of Finance. So far taxation of semi-formal village banks has not been enforced.
- Local financial activities and institutions have been registered with the governors of the respective provinces; NDTMFIs are also expected to be registered locally under the new regulation. It is not clear to what extent the governors have been involved in the consultation process.

Savings and credit unions (SCUs) can be local, single units or have branches and offices nationwide. 10 founding members together with 100 initial members, or 250 members with voluntary deposits of 300 million Kip, can establish a SCU; minimum capital requirements are 100 million Kip. SCUs are only allowed to provide financial services to members. With regard to credit, the regulation does not restrict SCUs to microloans. Prudential requirements include a maximum NPL ratio of 5%, provisioning, writing-off loans overdue >180 days, a risk-weighted CAR of 12% and liquidity ratios of 4% of cash in hand and 20% overall. SCUs have to be audited by externals and supervised by BOL. Reporting is quarterly and annual. Of the two prudentially regulated types of MFIs, SCU would seem to be the legal form most likely to appeal to village-based financial institutions required to convert. This is not surprising, as the leading village bank system in Vientiane Capital was inspired by international credit cooperative law. The highlights of the SCU regulation are summarized in Table 4; an overview is attached in *Annex 3*.

Table 4: BOL regulation: Savings and Credit Unions – Summary

Required to convert to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
Legal status	Financial cooperative
Location and outreach	National, members only
Portfolio restriction	No restriction to microloans
Establishment requirements	10 founding members and 100 initial members; or 250 members and voluntary deposits of 300m Kip No member shall own more than 10% of capital
Voting rights	One member, one vote (irrespective of the no. of shares held)
Resource mobilization	Member deposits, loans or grants from Lao and foreign entities and member share capital, retained earnings
Prudential regulation:	• Minimum registered capital 100m Kip • Provisioning for loans overdue >30, >90, <180 days; 1% on performing loans • Maximum NPL ratio: 5% of loans outstanding • Write-offs: loans overdue >180 days • CAR 12% (risk-weighted) • Liquidity ratios: cash in hand 4%; overall 20%
Auditing and supervision	Internal and external auditing, supervision by BOL Quarterly and annual reporting
Penalties for non-compliance	100,000 Kip per day to SCUs incl. managers or employees Suspension and cancellation of license
Interest rate restrictions	None

Deposit-taking microfinance institutions (DTMFIs) can be local, single units or have branches and offices nationwide. To establish a DTMFI it takes five shareholders and one major shareholder with at least 20% of registered capital, a total registered capital of one billion Kip divided into shares, and a five-year business plan demonstrating sustainability. Voting is by simple share majority. DTMFIs may provide financial services to the general public; but at least 80% of their portfolio must be comprised of microloans not exceeding ten million Kip. Prudential requirements include: voluntary deposits not exceeding 10 times the capital, a single-brrower limit of 10% of capital, provisioning as prescribed by BOL, including 5% on performing loans, a maximum NPL ratio of 5%, a risk-weighted CAR of 12%, liquidity ratios of 4% of cash in hand and 20% overall, and investments of up to 10% of registered capital but restricted to other MFIs. DTMFIs have to be audited by externals and are supervised by BOL. Reporting is monthly, quarterly and annually. The highlights of the DTMFI regulation are summarized in *Table 5* below; an overview is attached in *Annex 3*.

Table 5: BOL regulation: Deposit-taking MFIs – Summary

Conversion requirement to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
Legal status	Financial institution incorporated as a limited liability company under the enterprise law
Location and outreach	National
Establishment requirements	5 shareholders, 1 major shareholder Five-year business plan
Voting rights	One share, one vote, resolutions by simple majority of shares
Resource mobilization	Member deposits, loans or grants from Lao and foreign entities and shareholder capital, retained earnings
Portfolio restrictions	Microloans up to 10 million Kip at least 80% of loan portfolio
Prudential regulation:	• Minimum registered capital 1bn Kip, divided into shares • Voluntary deposits not exceeding 10 times the capital • Single-borrower limit 10% of capital • Provisioning for loans overdue >30, >90, <180 days; 5% on performing loans • Maximum NPL ratio: 5% of loans outstanding • Write-offs: loans overdue >180 days • CAR 12% (risk-weighted) • Liquidity ratios: cash in hand 4%; overall 20% • Investments up to 10% of reg’d capital, restricted to MFIs
Auditing and supervision	Internal and external auditing, supervision by BOL Monthly, quarterly and annual reporting
Penalties for non-compliance	100,000 Kip per day to SR-MFIs incl. managers or employees Suspension and cancellation of license
Interest rate restrictions	None

3. Village banks in Vientiane Capital

3.1 The practice of village banking in Vientiane Capital: survey results

This chapter introduces the operational practice of village banking as it has evolved in Vientiane Capital. It is based on the results of a survey of 40 large village banks in Saithany District, the first district in Vientiane Capital in which FIAM started promoting village banks in 1998. Information on village banks in the other eight districts in Vientiane Capital is not available in such detail; but these banks are modeled after those in Saithany. Having been established later on, they are generally not as advanced as the more mature village banks in Saithany. The survey was carried out by Mr Khanthone Phamuang, who has been involved in the design of village banking in Vientiane Capital from the start.

The objective of village banking as introduced by LWU is poverty reduction. The village banks were designed to activate self-help, provide mutual assistance, finance income-generating activities, assist with pre-harvest income so as to avoid selling the crop prematurely, prepare for and protect against emergencies and life events, improve living conditions and support village development.

Principles. The village banks were established as self-reliant local financial intermediaries that collect savings and recycle them as loans within the village. Self-help, or self-reliance, is the core principle. It is based on five strategic principles:

(i) self-determination by the general assembly through equal member votes,
(ii) self-financing through member savings,
(iii) self-management through an elected management committee,
(iv) self-governance[27] through an advisory committee made up of representatives of the community's political establishment, and
(v) self-supervision through district networks.

The target population comprises all local residents of a village, including women and men, with a focus on women as holders of the family purse strings, as is customary in Lao culture. In most families, both husband and wife have separate membership. All members save; in some village banks only women borrow.

Early impact. Members of the initial 20 focus villages quickly felt the impact of their involvement in village banking. Based on the collection and accumulation of small personal savings, they were able to borrow money when they were sick. This had previously been a major drain on their resources, since it forced them to turn to moneylenders. Now they could buy rice during periods of shortage instead of selling the paddy before harvesting; they were able to raise livestock; they had clean drinking water; and their general living conditions improved. This inspired other villages to join the project, and other organizations to start new projects establishing village banks. An immediate replicator was CODI with its Women and Community Empowering Project (WCEP).

Ownership: The village banks are owned by the members who are active savers. Ownership involves individual voluntary savings and the payment of a membership fee (similar to a share, but considered part of savings). Membership is restricted to the residents of the village where the village bank is located; it is not owned by the community acting as a corporate entity. This is similar to the cooperative ownership model, with its *one 'member, one vote'* rule, except that in village banks it is savings, not shares that constitute ownership.

Management and governance are in the hands of elected committees, all from within the village. Most of the people who sit on the committee are educated, older and respected community members. Management committees com-

27 Self-governance in the sense that it follows the rules of Lao village and society and not donors, as is common in credit NGOs and other MFIs in donor ownership. The advisory committee comprises various types of village representatives or authorities confirmed 'through election' by the general assembly, in line with the bylaws of the village banks.

prise five to seven members, on average six; 97% of the committee members in the sample were women. Advisory committees which represent the local power structure (including the local women's union) comprise four to seven members, on average six; 92% of the committee members are male. All committee members are reportedly elected by the general assembly, though in actual practice advisory committee membership is probably in many cases by appointment through some political process and confirmation, or ratification, by the general assembly. Committee heads tend to be re-elected and thus gain experience over time (an important prerequisite for effective capacity building). Presidents in the 40 village banks were in office up to nine years (*median:* five years), management committee members up to 12 years (*median:* seven years), and advisory committee members up to ten years (*median:* six years).

Ultimate power lies with the general assembly of members, whereby each member has one vote. The ultimate instrument of member control in case of general and substantive dissatisfaction with the running of the institution or unacceptable external impositions would be the withdrawal of savings.

Bylaws were reportedly inspired by international credit cooperative regulations. Model bylaws were provided by FIAM but each village shapes its own regulations. The bylaws specify membership criteria, general assembly terms and meetings, electoral procedures, terms and responsibilities of management and advisory committee members, the accounting system and financial reporting, membership fees, minimum monthly savings, deposit and loan disbursement date and place, loan criteria and terms, collateral and guarantees, interest rates for general and emergency loans, penalties for late payment and infraction of rules, profit distribution at the end of the year (including dividends to savers, compensation to management and advisory committee members, allocations to village development funds, social welfare fund, reserves), and membership as shareholders of district networks.

Guidance and supervision are provided by self-organized district networks comprising a two-tier zonal and district structure (possibly to be extended upwards to the municipality). In addition, LWU oversees activities at all administrative levels as does the district authority.

Financial products include savings, credit and life insurance. **Voluntary monthly savings** in Saithany are a minimum of 5,000 Kip ($0.60). In 2001 SRDP, with FIAM support, prepared a savings handbook that was revised in 2005.

Credit. There are two loan products: general and emergency loans. Initially most loans are emergency loans; with increasing maturity the share of general loans increases. As of 2009, 70% of the loans in Saithany are reportedly general loans. Emergency loans are for a maximum period of three months, at 1%-2% interest per month on the declining balance (12%-24% effective per annum), with payments not due before the second month. General loans are mostly for periods of up to one year. The interest rate has recently been reduced from 5% to 4% per month (i.e., from 60% to 48% effective per annum). Mature village banks may charge as little as 3% per month (36% effective per annum). This is to be compared to effective interest rates of up to 100% per annum on small loans (<10 million Kip) among some licensed MFIs. In the large village banks surveyed, the maximum loan size is mostly 20 million Kip ($2,350); in ten villages it is 50 million Kip and in one village 100 million Kip. In some village banks the maximum any member can borrow is five times the volume they have saved. If two people in a family are members (which is mostly the case), both can borrow. For loans up to 500,000 Kip ($60), personal guarantees are accepted; larger loans require physical collateral.

Late payments. Principal and interest installments are due monthly. Delays in repayment are widespread; but all borrowers reportedly continue paying interest on a monthly basis. There is no sense of urgency with regard to meeting all principal installment payments; penalties for late payment are, in fact, a major source of income. Monthly interest dues are reportedly met regularly. 14.9% of payments of principal in 40 village banks are overdue by more than 30 days:

4.1% 31-90 days
7.5% 91-180 days
3.3% more than 180 days.

Loans which are not repaid within the contract period are rescheduled. Borrowers who fail to repay a rescheduled loan have to meet with the management committee to work out a solution. There is no record of any bad debts having to be written off.

Balance sheet. Below is a simplified, consolidated balance sheet (including income and expenditure items) of 40 village banks, each with more than 500 million Kip in savings.[28] On average, each of these large village banks has 230 members and 890 million Kip in savings; average total assets are above one

28 Consolidation with the objective of arriving at a matching balance sheet required some adjustments by the survey team.

billion Kip. Net profit amounted to 23% of the amount of savings. 53% of the members are reportedly borrowers, approximately one per family.

Table 6: Adjusted balance sheet of 40 large village banks in Saithany District, October 2009 (in billion Kip)

Assets:	Amount	Liabilities + Capital:	Amount
Cash	4.76	Savings	35.56
Bank deposits	3.68	Interest income	6.88
Loans outstanding	34.56	Other income	0.03
Expenditure	0.80	Reserve Fund:	1.33
Total	**43.80**	**Total**	**43.80**
No of borrowers	4,864	No of saver-members	9,142

Loan purpose. The main loan purpose among the 40 large village banks is trading, followed by rice farming, family assistance and education. Identifiable income-generating activities account for about half the loan portfolio.

Table 7: Loan purposes in 40 large village banks in Saithany District, 2009 (amounts in million Kip)*

	Amount outstanding		Number of loans		
Loan purpose	**Amount**	**Percent**	**Number**	**Percent**	**Av. size**
Family assistance	4,086.0	16.3	1,090	20.1	3.7
Rice farming	3,391.9	13.6	1,152	21.2	2.9
Gardening	293.0	1.2	214	3.9	1.4
Livestock	425.5	1.7	63	1.2	6.8
Trading	9,023.8	36.1	1,237	22.8	7.3
Education	3,131.8	12.5	744	13.7	4.2
Sanitary facilities	415.9	1.7	163	3.0	2.6
Emergencies	869.2	3.5	440	8.1	2.0
Other	3,356.7	13.4	322	5.9	10.4
Total	24,993.8	100.0	5,425	100.0	4.6

*Incomplete data

Transactions usually take place during two consecutive days of the month: on one day savings and installments are paid, the next day loans are disbursed. The money collected is kept overnight by the cashier, who is chosen for his reliability, economic position in the village and the safety of his house. Frequently s/he is the head of the management committee or the head of the village. Five village banks have their own office space (owned by LWU or the village); the remaining 35 share facilities belonging to the village authorities.

Liquidity management. The high season for savings is January and February, and for loans August. Conversely, the low season for savings is October and

November, and for loans November and December. The main period of surplus liquidity is thus January and February; the main period of liquidity shortage is August. There are no liquidity exchange mechanisms in place between village banks in the district.

Taxation. Village banks, as semi-formal MFIs, do not pay taxes.

Profit distribution. Depositors do not receive a fixed interest rate. Similarly, committee members do not receive fixed monthly compensation and the village banks do not employ any salaried staff. Instead the net profit is calculated at the end of the year and allocated in the following ratios:

70 % dividend to savers (based on the amount of savings)
15 % compensation to management committee members
5 % compensation to advisory committee members
4 % reserve fund
4 % development fund
2 % network services

Perception of microfinance regulation. 18 months after the new microfinance regulation had been announced, village banks are still not fully aware of its contents. This has raised fears which may or may not be justified. Despite the similarity between village banking and cooperative finance, there is a deep distrust of credit cooperatives, due to the collapse of credit cooperatives and their associations with the former command economy. The village banks have a strong preference for their own system based on self-determination and voluntary savings. At the same time, they see the need to register with BOL, provided they can do so with their current system.

Development perspectives and demand for support. The village banks have voiced the following concerns and suggestions:

- Management training and capacity-building for committee members
- Own office, computers, an improved accounting system
- Increased savings, introduction of term loans, lower interest rates
- Safekeeping and better use of surplus liquidity
- Further information about the microfinance regulatory framework
- Microenterprise management, marketing and skills training

3.2 Outreach and performance of village banks in Vientiane Capital: an overview

The municipality of Vientiane Capital comprises nine districts[29] with 499 villages and a total population of 712,000 inhabitants[30] in 126,000 households (i.e. 5.65 members per household). On average, each village has 1,427 inhabitants in 253 households *(2006 data).*

Early beginnings. It is not clear whether there is any correlation between the beginnings of village banking in the early 1990s, supported by two NGOs, and their emergence later on as reported below. Whether any of the early 114 village banks or groups have survived in the villages not covered by FIAM and CODI remains a matter of conjecture. The Adventist Development Relief Agency (ADRA) has been involved in Laos since 1991. With funding from the World Food Program (WFP), ADRA helped establish rice banks in 112 villages in Vientiane Capital. Loans outstanding from 6,136 rural households in 1996 amounted to $594,080. With an interest-free loan of $25,000, ZOA Refugee Care reportedly helped establish "sustainable village credit associations (groups) that can be profitable and are managed by the villagers themselves" in three villages. Loan sizes varied from $22 for handicraft loans to $329 for buffaloes. ZOA also introduced a revenue-sharing model as a precursor to FIAM's later profit-sharing model: 40% of interest income goes into an emergency fund, 12% into an inflation reserve, 36% is used for the committee, one district staff member and administrative expenses, and 12% is net profit. (UNDP/CDF 1996: 41, 59-61)

The NERI survey, 2006. According to a survey by NERI (2007), there were 190 microfinance service providers in Laos in 2006; 15 of these were in Vientiane Capital, including projects & funds, mass organizations and line government agencies with a reported coverage of 97% of all villages. Thus Vientiane Capital ranks third in the country, after Savannakhet with 25 and Vientiane Province with 17 providers. The survey does not offer information about the number of village banks or other microfinance institutions. Key information, albeit incomplete[31], provided by NERI on the municipality as of 2006 includes the following:

29 Chanthabuly, Hadxaiphong, Pakngum, Naxaithong, Sanghtong, Sikhottabong, Saithany, Saysettha and Sisattanak.

30 67.0% of the population of the municipality is aged betweeen15-64.

31 All 15 providers gave information on total capital (presumably comprising liabilities and equity). and savings, 14 on loans, 10 on equity and 11 on profit.

- 26,582 savers, 18.54 billion Kip in savings, 0.70 million Kip per saver
- 8,190 borrowers[32], 15.71 billion Kip in loans, 1.92 million Kip per borrower
- Equity 3.07 billion Kip, 12% of total assets
- Total liabilities and capital 25.48 billion Kip
- Profit 2.17 billion Kip

FIAM and CODI data, 2009. No recent comprehensive survey data is on hand for Vientiane Capital. However, as of September 2009, 91% of the villages in the municipality were served by village banks supported by two providers, both in cooperation with the Lao Women's Union, which are active in all nine districts of the municipality: namely, the Foundation for Integrated Agriculture Management (FIAM), a Thai NGO, and the Community Organizational Development Institute (CODI), a Thai development agency, both of which started out during the second part of the 1990s. The two projects have two basic features in common: (a) village banks start by mobilizing savings and remain savings-based; (b) within a few years, they build up self-managed and self-financed network structures for monitoring and supervision:

- LWU and FIAM started the **Small Rural Development Project for Women (SRDPW)** together and began establishing village banks in Saithany District in 1998, reaching a total of 107 village banks in 2009. Since 2003, LWU and FIAM have been building a network structure in Saithany District to take care of monitoring and supervision. In 2002 they started building village banks in Saysettha District; the total number on hand in 2009 was 44, 39 of which were promoted directly by FIAM, four by an affiliate local NGO and one established through a local initiative. However, there is no network structure in that district, and information about outreach and finances is limited. Thus, the total number of village banks under FIAM, together with five indirectly associated village banks, is 151.
- Following the lead of its project with FIAM, LWU started a similar project in the remaining seven districts with CODI, the **Women and Community Empowering Project (WCEP).** The first village banks were set up in Pakngum District in 2000 and in Sangthong and Naxaithong in 2002, followed by a network structure in 2003 and 2006 respectively. In the remaining four districts, implementation started in 2003-04, followed by the creation of a networking structure in 2008-09. The total number of village banks had reached 302 by 2009.

32 The late payment rate is given as 0.6% – a most unlikely figure, lending little credence to the reliability of survey results.

It should be noted that both providers have succeeded in building up a functioning reporting system, as indicated by the fact that data from 30 September were available during the first part of November. Key information by the two providers as at September 2009 is summarized below. This also includes information about Saysettha District[33], which is not part of regular reporting by the existing village bank networks:

- 453 village banks (out of 499 villages) under LWU with FIAM and CODI in all 9 districts of Vientiane Capital
- 48% of the families in Vientiane Capital are members in one of the village banks, usually both wife and husband.
- 103,902 member-savers, 229 per village bank;
- 126.73 billion Kip in savings, 280 million Kip per village bank
- 29,565 borrowers, 65 per village bank;
- 135.36 billion Kip loan portfolio, 299 million Kip per village bank
- 25,445 life insurance participants (excluding Saysettha)
- Reserve funds 4.52 billion Kip
- Total liabilities and capital 164.56 billion Kip
- Interest received 19.42 billion Kip
- Dividend to savers in percent of total savings 10.74%
- Around 193 village banks with more than 200 million Kip in savings
- (70 in Saithany District, 105 in seven districts under CODI and an estimated 18 in Saysettha)

3.3 Laying the foundation: village banks in Saithany District

Saithany is one of nine districts in Vientiane Capital, and is known for the strength of its village banks which account for more than a quarter of the total number of village banks in the eight districts under FIAM and CODI, the two main promoters in the municipality, as well as for around half the total funds and the loan portfolio. The district was therefore selected for a special study.

System preparations started in 1997 within the framework of SRDPW, under adverse conditions: first, the credit cooperatives had collapsed, then, in 1997/98, the Asian financial crisis hit Laos, seriously affecting its financial sector. In both cases Laotians lost their savings. Yet, they were not discouraged

33 Data on the number of village banks, the number of members and the amount of savings in Saysettha were provided by Khanthone; other consolidated data were adjusted accordingly (except for the number of participants in life insurance, which presumably does not exist in Saysettha).

but were ready for a local institution under their own control. FIAM, in cooperation with LWU, worked out the methodology for establishing village banks: self-financed through member savings, self-managed through an elected management committee, self-governed through an advisory committee of elected representatives of the community power structure, and self-reliant through an ingenious system of cost control. Project implementation was actively supported by the Women's Union at Vientiane Capital and district level as well as by the deputy mayor of Vientiane Capital and the Saithany District chief.

System and financial reporting specifics. The system developed by FIAM, and subsequently adopted by CODI, incurs very few costs during the year, while income is generated through interest payments on loans, penalties for late payment and membership fees from new members. At the end of a financial year, net income is calculated and allocated according to a generally agreed distribution ratio: namely, as dividends to savers (70%), compensation for management (15%) and advisory committee members (5%), reserves (4%), special funds (4%) and network services for monitoring and guidance (2%). Preparations also included a manually administered accounting system, adjusted during 1998-2000 to the needs of evolving institutions. The financial year starts with the month in which a village bank was established. The main deviations from BOL reporting requirements are given below:

- No salaries and compensations appear as expenditure on the income statement.
- Income and minor expenditure items are integrated in the balance sheet and on the liability and asset side respectively.
- On the basis of the annual income and expenditure statement, net income is calculated and allocated to various categories, including dividends to savers, compensations to management and advisory committee members, reserves and funds, and network & supervision costs.
- The financial year is not standardized and varies in keeping with the foundation date of each village bank.

An example of an actual annual financial report, by the village bank of Phaksapkau, is given in *Annex 4*.

The first village banks were established in Saithany District in 1998. They only had women members who also elected women-only management committees. In 2000 men were allowed to join, which gradually led to a more evenly balanced membership. But some village banks however still continue to lend only to women whilst taking savings from both genders. The same year saw the introduction of advisory committees made up of appointed representatives of the local power structure, most of them men. This completed what Khanthone Phamuang, author of a handbook on village banking in 2001, called the *tripod of governance:* member-owners, an elected management committee and an elected advisory committee or board. The handbook, and with it the model developed in Saithany, was used by FIAM and CODI as well as by the Ministry of Planning and Investment to spread village banks country-wide. The data reported below are based on monitoring information[34] by the village bank network center, established with FIAM's assistance.

The center has some 107 village banks under it in Saithany District; i.e. 102 village banks from 104 villages, plus five special institutions from the police, military, district administration, public health unit and district education unit. Total membership is 35,000, all of them savers. It is common for both wife and husband to be members; almost 18,000 families are served by the village banks. Nearly 10,000 members currently have a loan outstanding, i.e., 28% of members. The average number of members and borrowers per village bank is 327 and 91, respectively.

Total funds are 63.2 billion Kip ($7.4 million), comprising savings of 52.1 billon Kip ($6.1 million), interest income of 8.2 billion Kip ($0.97 million), a reserve fund of 2.0 billion Kip ($0.24) and a development of 0.14 billion Kip ($0.02 million). Total loans outstanding amount to 62.1 billion Kip ($7.3 million) – 98.2% of total resources. The village banks operate on a zero-cash principle and keep very little liquidity; almost all liquid resources are normally lent out within two days after the monthly deadline for receiving deposits and repayments. Average savings per village bank amount to 487 million Kip ($57,253), average loans outstanding to 580 million Kip ($68,255). Average savings per member are 1.5 million Kip ($175), average loans outstanding per borrower 6.4 million Kip ($752), average loan size disbursed is probably above 10 million Kip ($1,200). *(Table 8)*

34 These data were not available at the beginning of the field work, but were discovered during a visit to the district administration office where a network center was found to exist, replete with a room (since February 2009) and a staff of four.

Table 8: Village banks under FIAM in Saithany District, Sep. 2009 (in Kip and US$)

Outreach data:		
	Total	**Av. per VB**
No of VBs	107	
No of members	34,946	327
No. of families (est'd.)*	17,622	165
No of borrowers	9,716	91
Life insurance participants	4,643	
Financial data:		
	Million Kip:	**Million US$:**
Loans outstanding	62,078.1	7.30
Savings	52,071.3	6.13
Interest received	8,236.9	0.97
Other income (net)**	737.7	0.09
Reserve fund	2,043.9	0.24
Development fund	135.1	0.02
Total. funds	*63,224.9*	*7.44*
Average amounts:		
	Million Kip:	**US$:**
Av. savings per VB	486.6	57,253
Av. reserve fund per VB	19.1	2,247
Av. loan portfolio per VB	580.2	68,255
Av. savings per member	1.5	175
Av. loan outst. per borrower	6.4	752
Exchange rate:	*8500*	

* Estimated at a rate of 50.4% as in 7 other districts of Vientiane Capital for which data exist by CODI.
** Penalties + membership fees – expenses

Dividends on savings: The village banks do not pay any interest on savings and nor any monthly salaries or other regular compensation. Instead, annual profit is allocated according to a scheme adopted by FIAM, including dividends to savers, management and advisory committee members. As of September 2009, total profit amounted to 9.0 billion Kip, 70% of which (6.3 billion Kip) was allocated as dividends to savers, which is equivalent to 12.1% interest.

Table 9: Consolidated profit allocation of 107 village banks in Saithany District, 2009 (in million Kip)

Profit allocated to:	Percentage	Amount
Savers	70	6,282.19
Management committee	15	1,346.18
Advisory committee	5	448.73
Reserve fund	4	358.98
Development fund	4	358.98
Network services	2	179.49
Total profit	100	8,974.56

Saithany District is divided into twelve zones, with between four to twelve village banks per zone, the average being nine. *Table 10* gives the number of members and the savings balance per zone, and the averages per village bank within each zone.

Table 10: Saithany District: Savings of >200 mn and >1 bn Kip by zone, Sep 2009 (in mn Kip)

Zone		No of VBs	Members	Av./VB	Savings	Av./VB	Sav >200m	Sav >1bn
1	Houaxieng 1	8	3,961	495	7,628.0	953.5	7	2
2	Houaxieng 2	4	1,138	285	2,312.6	578.2	2	1
3	Khoksivilai	11	2,310	210	3,907.8	355.3	7	0
4	Houaychiam	10	1,685	169	1,933.5	193.4	4	0
5	Dongbang	12	2,465	205	3,624.9	302.1	7	<1*
6	Banxai	10	3,249	325	4,227.9	422.8	8	<1*
7	Dongdok	9	4,000	444	7,226.4	802.9	8	5
8	Sivilai	8	4,607	576	7,588.1	948.5	7	2
9	Thangone	12	4,936	411	6,282.6	523.6	9	<2*
10	Veukham	7	1,332	190	355.4	50.8	0	0
11	Hatkiang	8	2,903	363	2,966.2	370.8	6	0
12	Banxang	8	2,360	295	4,017.9	502.2	5	1
	Total	**107**	**34,946**	**327**	**52,071.3**	**486.6**	**70**	**11 + <4**
	Percent of VB with. >200 million and >1 billion Kip resp. in savings						65%	14%

*Slightly less than one billion Kip

Village banks in Saithany District vary widely in outreach and resources, ranging from newly established village banks with less than 50 members and less than 10 million Kip in savings[35] up to one village bank, established in 1998, with 1,356 members and a savings balance of 2.7 billion Kip or $320,000 – i.e. 2.0 million Kip or $237 per member. Yet another village bank, established in 2001, has some 964 members and a savings balance of 3.2 billion Kip or

35 The smallest with 5.3 million Kip in savings, established in June 2009.

$375,000 – i.e. 2.2 billion Kip or $392 per member. The age of the village bank and the size of the village, together with economic potential, are major determinants of growth, but so is governance. Among the early village banks established in 1998 are two (both in zone 3) with approximately 70 members and less than 30 million Kip in savings – that is 0.4 million Kip or $49 per member. Existing data is not adequate to undertake an analysis of growth and strengths (or weaknesses).

Village banks with >200 million Kip in savings. The regulator has established a floor of 200 million Kip as one of the indicators above which a village bank has to be regulated. In three zones, 80% or more of the village banks have more than 200 million Kip in savings. In one of the zones, five of the eight village banks have more than one billion Kip in savings. Overall, out of the 107 village banks, 70, or 65%, have more than 200 million Kip in savings; 11 village banks have more, and another four almost one billion Kip in savings, making 15 in all.

In total, village banks in Saithany District exhibit impressive strength, with a large number of them exceeding the regulatory savings threshold. Here are some key data:

Table 11: Key data of village banks in Saithany District, Vientiane Capital, Sep 2009

Number of village banks	107	
Average number of members	327	
Average savings balance per VB	486.6 mn Kip	$57,253
Average reserve fund per VB	19.1 mn Kip	$2,247
Av. loan portfolio per VB	580.2 mn Kip	$68,255
Dividend to savers in percent of savings	12.1%	
VBs with more than 200 million Kip in saving	70	
VBs with approx. 1 billion Kip in savings or more	15	

3.4 Extension to the remaining eight districts of Vientiane Capital

Expansion to the remaining districts in Vientiane Capital has been promoted by two agencies: FIAM in one and CODI in seven districts.

3.4.1 Extension to Saysettha District

Some 44 village banks have been established in Saysettha District, all following the FIAM model. FIAM itself promoted the establishment of 39 village banks; another four were initiated by NALD under Khanthone Phamuang who also promoted village banks in the remaining seven districts. One village bank was established through local self-help. There is no network organization in Saysettha District to provide monitoring data. No data beyond those given in *Table 12* are available.

Table 12: Village banks in Saysettha District

No of village banks	44
Estimated no of VBs with >200m Kip in savings	18
No of members	8,883
Amount of savings in million Kip	10,609.2

3.4.2 Extension to seven districts

In line with the model established by FIAM in Saithany District, a Thai government development organization by the name of CODI has been promoting village banks in seven other districts of Vientiane Capital.

There are 302 village banks in the seven districts, six of them under the care of a network center and the guidance of a promotional office[36]. The data reported below are based on monitoring by the network centers. Total membership numbers almost 60,500; all members are savers. It is common for both wife and husband to be members. Some 30,500 families are reported to have access to village banks. 17,000 members currently have a loan outstanding, i.e. 28% of members. The average number of members and borrowers per village bank is 202 and 57 respectively. The village banks in the seven districts are thus smaller than in Saithany, which may be due to the later date at which they were established.

Total funds amount to 77.95 billion Kip ($9.2 million), comprising savings of 64.05 billon Kip ($7.54 million), net income of 8.8 billion Kip ($1.04 million), a reserve fund of 1.84 billion Kip ($0.22), a development fund of 0.47 billion Kip ($0.05 million), a study tour fund of 0.61 billion KIP ($0.07 million) and a wel-

36 Headed by Mr. Khanthone Phamuang who was also the leader of the Saithany survey team.

fare insurance fund of 2.14 million Kip ($0.25 million). Total loans outstanding amount to 62.9 billion Kip ($7.4 million) – 80.7% of total resources.

Average savings deposits per village bank amount to 214 million Kip ($25,118) and average loans outstanding to 210 million Kip ($24,656) – in other words, 44% and 36% of the respective average amounts in the village banks in Saithany.

Average savings per member are 1.06 million Kip ($125), average loans outstanding per borrower 3.69 million Kip ($434) – this translates into 79% and 58% of the respective amounts in the village banks in Saithany. *(Table 13)*

Table 13: Village banks in 7 districts of Vientiane Capital, Sep. 2009 (in Kip and US$)

Outreach data:		
No of VBs	302	
No of members	60,470	
No. of families	30,477	
No of borrowers	17,029	
Life insurance participants	20,802	
Av. no of members per VB	200	
Av. no of borrowers per VB	57	
Financial data:	**Million Kip:**	**Million US$:**
Loans outstanding	62,872.4	7.40
Savings	64,050.5	7.54
Interest received	8,424.3	0.99
Other income (net)*	417.6	0.05
Reserve fund	1,837.7	0.22
Development fund	466.1	0.05
Study tour fund	613.4	0.07
Welfare insurance fund	2,141.4	0.25
Total funds	77,951.0	9.17
Average amounts:	**Million Kip:**	**US$:**
Av. savings per VB	212.1	25,000
Av. loans per VB	208.2	24,500
Av. savings per member	1.06	125
Av. loan outst. per borrower	3.7	434
Exchange rate:	*8,500*	

* Penalties plus membership fees minus expenses

Dividends on savings: As in Saithany District, annual profit is allocated according to the same scheme used by FIAM, including dividends to savers, management and advisory committee members, allocations to the reserve fund and to a development fund and a fee for network services. As at September

2009, total profit amounted to 8.8 billion Kip, 70% of which (6.2 billion Kip) was allocated as dividends to savers (almost the same amount as in the district of Saithany alone); this is equivalent to 9.7% interest on savings. *(Table 14)*

Table 14: Consolidated profit allocation of village banks under CODI in seven districts of Vientiane Capital, 2009 (in million Kip)

Profit allocated to:	Percentage	Amount
Savers	70	6,189.31
Management committee	15	1,326.28
Advisory committee	5	442.09
Reserve fund	4	353.67
Development fund	4	353.67
Network services	2	176.84
Total profit	*100*	*8,841.87*

The number of village banks in the seven districts under CODI varies from 24 in the most recently added district to 55, the average number of members per village bank from 126 to 355, the loan portfolio from 51.3 million Kip to 405.7 million Kip. The number of members in District 5, Chanthabouly[37] is estimated at 5,700 which brings the total number of members up to 60,470. 105 village banks (35%) have more than 200 million Kip in savings. *(Table 15).*

Table 15: Village banks under CODI by district, 30 Sep. 2009 (in million Kip)

District	Name of district	No of VBs	Members	Av./VB	Savings	Av./VB	Sav >200m
1	Pakngum	55	13,016	237	17,461.2	317.5	30
2	Sangthong	37	5,350	145	4,512.6	122.0	8
3	Naxaythong	55	19,511	355	22,311.3	405.7	40
4	Sisattanak	42	5,290	126	4,294.2	102.2	8
5*	Chanthabouly	37	5,700	154	6,628.6	179.2	6
6	Sikhottabong	52	8,188	158	7,610.6	146.4	11
7	Hadsayphong	24	3,415	142	1,232.1	51.3	2
	Total	*300*	*60,470*	*202*	*64,050.6*	*213.5*	*105*

*Number of members in District 5 estimated

Key data on the village banks in the seven districts under CODI are summarized in *Table 16.*

37 The number of village banks in Chantabouly has been recently updated from 35 to 37. No information is on hand concerning the two additional village banks.

Table 16: Key data on village banks in Vientiane Capital under CODI, Sep 2009

Number of village banks	302	
Average number of members	200	
Average savings balance per VB	212.1 million Kip	$25,000
Average reserve fund per VB	6.1 million Kip	$721
Av. loan portfolio per VB	208.2 million Kip	$24,500
Dividend to savers in percent of savings	9.7%	
VBs with more than 200 million Kip in saving	105	
VBs with 1 billion Kip in savings or more	15	

4. Village banking networks in Vientiane Capital

4.1 Overview

Initiative and coverage. Self-sustaining village bank networks have been initiated by LWU together with FIAM and CODI in all but one district of Vientiane Capital. The first network was established by FIAM in Saithany District in 2003. This was followed by CODI during the same year in Pakngum District, next in Sangthong and Naxaithong in 2006, and finally in Sisattanak, Chanthabouly, Sikhottabong and Hadxaiphong in 2008-09. By the end of 2009, eight of the nine districts in Vientiane Capital had their own networks; the remaining district, Saysettha with 44 village banks, is expected to be included in 2010.

Table 17: Networks of village banks in Vientiane Capital

Name of district	Promoter	Year of establishment	No of VBs
Saithany	FIAM	2003	107
Pakngum	CODI	2003	55
Sangthong	CODI	2006	37
Naxaythong	CODI	2006	55
Sisattanak	CODI	2008-09	42
Chanthabouly	CODI	2008-09	37
Sikhottabong	CODI	2008-09	52
Hadxayphong	CODI	2008-09	24
Saysettha	FIAM	Expected in 2010	44
Total number:		*8*	*453*

4.2 The village banking network in Saithany District

The network in Saithany has served as a model for the networks in the other districts of Vientiane Capital as well as in other provinces and has inspired a number of donors. It was established as a nonformal organization (i.e., without a legal status), on 31 January 2003 and was initially run by honorary staff from within the district administration premises which also houses the District Lao Women Union, the prime driver of the networking process.

Objectives. Each network has a multi-tiered structure with an interrelated set of purposes:

- Disseminate village banks in the area
- Strengthen them in response to member demands
- Share experience within the zones and the district,
- Strengthen member participation to develop their village, zone and district
- Train village bank and committee members,
- Gather information and report
- Monitor and supervise
- Manage a voluntary life insurance fund, referred to as welfare fund
- Cooperate with partners
- *more recently:* Set up a communication link with the regulator.

Principles. The networks are built on similar principles as the village banks: self-reliance and sustainability based on cost coverage and self-financing, self-management, self-regulation and self-supervision.

Costs are borne by the village banks. 2% of their profits are allocated for the salaries and expenses of the chairperson and adviser at the center and the allowances of the zonal committee members.[38] Through to 2010, two accountants were paid by FIAM. As of 2011 they are expected to be paid from the VB profit allocation.

Structure of the network. In Saithany, the network is comprised of a center with a permanent staff and a committee; 12 zones, each with their own committees; 107 village banks, each with a management committee and an advisory committee and, at present, 35,000 members as owners of the network.

38 In actual fact most are chosen from management and advisory committees and may receive no extra payment.

At the central level the district network has two organs: a network committee of representatives elected by the zonal committees and a network center. The network committee has 17 members: one delegate from each of 12 zones in Saithany, one representative each of the Women's Union of Vientiane Capital (who is also the head of Center office), of the District Women's Union and of the Rural Development Project (FIAM), and two advisers. Committee meetings take place quarterly.

The network center has a full-time staff contingent of four women: a chairwoman, an adviser who is a retired president of the District Women's Union, and two accountants: one in charge of center finances, the other administers a voluntary welfare-cum-life-insurance fund. Since February 2009, the network center has been given a room as a permanent office in the premises of the district administration, equipped with four desks and a computer.

Zonal committees. The 107 village banks of Saithany District are divided into 12 zones *(khumban)*, each with a zonal network of nine village banks on average and a committee representing the member institutions. The size of the zonal committee thus depends on the number of village banks in the zonal network. Each village bank elects a representative and a substitute. Each zonal committee elects an executive board of three, comprising a chairwoman and two deputies, one of whom serves as an accountant. Elections are usually held every two or three years. Meetings are quarterly. Committee members receive remuneration from the village banks' 2% profit-sharing allocation. Each zonal committee elects a representative to the district committee and a substitute.

The zonal committees occupy an intermediate position between the committees of the village banks and the district committee without any power of their own. In terms of governance, their function is reportedly a mere *sharing of experience – leak pian kham han,* involving communication up and down the line, but without any decision-making or enforcement power. The zonal committees reportedly "do not give advice"; all issues requiring decision-making, "advice" and action are passed on to the district committee.

The representatives of the village banks collect monthly financial data from their respective institutions which they pass on through the zonal board to the district network center. The zonal committee meets quarterly to discuss all information gathered from the village banks and received from the network center. In addition to reporting, the functions of the zonal committees and their representatives include monitoring and inspection, guidance in accounting and other matters, discussing issues and suggesting possible solutions.

The zonal committee board prepares quarterly financial reports and other reports, e.g. on activities and problems, and submits them to the center.

Ownership of the village banks by network shareholders is based on member savings as the main source of funds. While there is a membership fee, this is not considered share capital. Savings thus constitute ownership and it is through them that members derive their power. This is most evident when members become dissatisfied with the way a village bank is being run (due to internal or external factors) and so withdraw their savings, thus leading to the decline of the village bank as a financial institution and at the same time of member dividends and of remunerations to committee members, which are a major source of income. In this respect, the members are ultimately more powerful than their various network committees and even the regulator. Thus, any processes pertaining to the village banks must be accepted by the members, lest they withdraw their savings.

Ownership of the network at zonal and district level is based on VB shareholding, whereby the village banks elect representatives at zonal and district level and finance all network expenses from a fixed share of the profit. The zonal and district committee members thus have a direct material interest in the village banks' profitability.

Network governance is bi-polar, reconciling the power of the people and the power of the center. Governance rests at the bottom with the village-bank members who elect the zonal committee members who, in turn, elect the district representatives, and finance the network; and at the top it also rests with the district committee and network center. The representatives of the LWU are involved at all network levels – in village bank, zonal and district committees – and are linked to the LWU at provincial and national levels.

Reporting and supervision. The district center has assigned responsibility for inspecting the books and collecting financial data and other information – including problems encountered by the village banks – to the zonal and village committees, to be reported from the village level up the line to the center. The center staff enter manually transmitted financial data pertaining to the village banks into a computer at zonal and district level and prepare monthly, quarterly and annual reports. The reports are sent to the LWU at district, Vientiane Capital and national level. As the reporting system is relatively new and still evolving in the districts of Vientiane Capital, no central processing and reporting facility is presently in place at LWU. There is no evidence that any of this information is shared with the central bank.

Inspection of the village banks is in the hands of the zonal committees; it does not seem to be professionalized. Center staff is directly involved in only two inspections: the chairperson of the center inspects dividend payment in village banks and the adviser inspects the share books of village banks that hold shares in the center. The two accountants at the center are subject to internal controls by the district committee.

A case of effective supervision. The reports submitted to the center are discussed quarterly by the district committee. Action to be taken is normally delegated to the zonal committees. Emphasis is on persuasion rather than on enforcing compliance. An example here is the village bank of Thongmang whose poor management and governance caused many members to withdraw their savings. After the problems had been reported to, and discussed by, the district committee, the zonal committee, in cooperation with the district center, took action by discussing the problems with the members. This led to the management and advisory committees being re-elected, right up to a new president. Proper procedures were installed and confidence restored, leading to the village bank's recovery and subsequent progress. Overall, it is claimed that supervision is fairly effective and has strengthened the village banks, resulting in an increase in membership and savings. However, this claim requires further corroboration. Meanwhile, the overall effectiveness of governance by representatives of the village authorities does give rise to certain questions.

Life insurance. Managed by the respective network centers, the networks in Vientiane Capital have set up voluntary welfare funds to function as life insurance. In Saithany District, under FIAM guidance, every participant pays 1,000 Kip by way of life insurance so that, in the event of death, the deceased's family receives three million Kip, whereby the same amount is allocated to the network's reserves. The scheme has 4,643 participants. One of the accountants is responsible for its administration. In Saithany, the welfare fund is not reported on the consolidated balance sheet. In the other seven districts under CODI, a total of 20,802 village bank members participate in the scheme, which obviously functions as an effective mobilizer of savings. As at September 2009, total resources accumulated in the welfare fund amounted to 2.14 billion Kip ($250,000).

4.3 Network response to the microfinance regulation of 2008

The district network center welcomes BOL's initiative to take responsibility for microfinance and shares its concern for the development of a strong and sustainable sector. The center has been notified of the June 2008 regulation and has participated in a seminar. Three steps are being taken: (i) examine the regulation (ongoing); (ii) disseminate information among village bank members and hear their views; and (iii) ask for directions from LWU. The members of the village banks are of crucial importance, because they own the groups and the savings. The process of VB registration and regulation must involve the village bank members as active partners, as they might withdraw their savings.

Status-quo. By the end of 2009, none of the village banks had responded to the registration and licensing requirement within the one year period ending June 2009 set by BOL.

Regulation as an evolutionary process. Appropriate regulation is an evolutionary process, requiring communication between the stakeholders. This implies a double challenge: the village banks have to learn to communicate with the central bank; the central bank has to learn to listen to the village banks. At its core, effective communication involves the village banking networks and BOL, together with major service providers and donors, LWU and BOL.

SCU preference, if regulation can be adjusted. Groups with savings of more than 200 million Kip have to be licensed: as deposit-taking MFIs or savings and credit unions (SCUs). **Members are likely to prefer the SCU model,** provided the regulation can be adapted to accommodate some of the village banks' practices. The regulation is not adjusted to the practice of profit-sharing at the end of a financial year, which not only includes paying out dividends to members as a substitute for interest payments on savings, but also remuneration for management and advisory committee members instead of fixed, monthly salaries or compensations.

Indeed, by examining village banks in Laos, microfinance experts worldwide can learn how to keep costs under control and guarantee viability: namely by voiding fixed salaries and interest payments on savings during the year and deferring all remunerations to profit-sharing at year's end. However, some questions remain with regard to governance, transparency and accountability within village banks.

Regulation will also impact operational practices. Village banks in Laos have been reluctant to enforce timely repayment. Penalties on loans overdue are a major source of income; and the management committees have been generous in rescheduling loans. At the same time, it has been noted that defaulting rarely occurs at all. Even if people die, their debts – for spiritual reasons – are settled by their relatives. Thus, village banks are notorious for high portfolio-at-risk ratios (PAR). This does not signify terminal illness, as it might otherwise do in microfinance institutions in other countries. However, perpetual delays in repayment have a negative impact on cash-flow and the availability of resources for new loans, which are generally in short supply, as the financial reports of the village banks indicate.[39] It may also undermine the investment culture, leading to complacency among the borrowers who may pay less attention to cash-flow management and be less inclined to put their loans in high-yielding investments. It may be difficult for committee members to enforce repayment in a tightly knit community, if not compelled by an outside force. Via training on incentives for timely repayment[40] and good governance in general, appropriate regulation is likely to have a positive impact on the credit and repayment culture.

4.4 Network responses to other policy options

Feasibility of a central fund. Saithany District's network center has no definite view on the establishment of a central fund at district level, but is considering this as an option once FIAM support stops. A central fund at national or municipality level is not considered an option. As a source of finance, the network center would consider selling special shares to village banks that would then own the fund in the capacity of a network subsidiary.

Attitude to solidarity group lending. According to the network center staff in Saithany district, and as confirmed by survey findings by Khanthone, village banks are opposed to two aspects of a Grameen Bank Approach (GBA): (a) regular weekly meetings and (b) mutual guarantees within solidarity groups. However, this attitude is confined to urban and periurban areas as in Vientiane Capital, where urbanization has undermined the trust and honesty that used to be so characteristic of traditional Lao society.

This finding does not apply to rural areas, particularly to remote and poor districts, where traditional values and practices are still upheld. So far Sparkassenstiftung has not encountered any objections to the weekly meetings and mutual guarantees in its WFDF project.

39 Incoming funds are normally lent within two days, and liquidity reserves are minimal.

40 As in the microbanking units of Bank Rakyat Indonesia (Seibel 2009).

5. Strengths and weaknesses of village banks and village banking networks

5.1 Strengths

5.1.1 Strengths of village banks

Cultural integration. Village banks in Vientiane Capital have evolved over the past ten years as a uniquely Laotian microfinance model. Technical assistance from neighboring Thailand, together with the cultural sensitivity of Lao program management, has played a formative role in designing a culturally adapted system. Without exception, a single village community is the preferred social and economic space of a village bank in Vientiane Capital. Membership is voluntary and self-selected; compulsory or automatic membership would not be accepted. Two factors of Lao culture manifest themselves in membership and ownership. One is the financial power and responsibility of women in village society and their role as holders of the family purse strings and in cash income-generating activities. Both women and men are members, in fact, usually both husband and wife; but women are prominent as founding and management committee members, and they decide whether men may also borrow. The other factor is a pronounced propensity to save which is a strong cultural preference throughout Laos. Depositing savings is the first purpose of a village bank in Vientiane Capital; access to credit is secondary. Membership and ownership are attained through saving; a saver is a member, and a member is a saver. There is also a religious element involved in the credit culture. Payments may be delayed, and loans may be rescheduled; but ultimately defaults are rare as these would affect reincarnation.

Outreach. In purely quantitative terms outreach is the greatest strength of village banks in Vientiane Capital. At 91%, village coverage is almost complete. Half the families are members. Out of 104,000 member-savers, 30,000 are borrowers (with a loan outstanding) and there are 25,000 life-insurance participants. Total assets amount to 153bn Kip ($18m) – a remarkable figure in a generally undermonetized economy. Average membership per village bank is 229, with 338m Kip in total assets, 280m Kip in savings, 65 borrowers and 299m Kip in loans outstanding. Outreach is strongest in Saithany District, with a village coverage of 98%, an average of 327 members and 91 borrowers per village bank, 487m Kip in savings and 580m Kip in loans outstanding.

Village banks with more than 200m Kip in savings are to be prudentially regulated. Nearly 200 village banks (43%) in Vientiane Capital fall into that category. Seven village banks have more than 1,000 members. Saithany District has the highest density of large village banks, with 70 out of 107 (65%), accounting for around half the total funds and loan portfolio of village banks in the municipality; it also has the strongest self-organized network structure.

Self-governance of village banks in Vientiane Capital comprises a "tripod of governance" *(Khanthone):* member ownership with ultimate decision-making power, self-management through a mostly female management committee, and internal control through a mostly male advisory committee (or *board*) representing the local power structure. LWU plays a prominent role and is a part of all three elements of the tripod structure.

Financial self-reliance. Village banks in Vientiane Capital are fully self-financed through savings, their major source of loanable funds and growth motor. Profits are used to compensate savers and committee members and for other purposes. Donor seed funds, capital grants and credit lines are nowhere to be found which means they are not at risk of developing a dependency syndrome.

Financial technology is demand-driven and individual. Owing to a lack of solidarity in a urban and peri-urban environments, there are no group loans. Almost all assets are earning assets; almost all liquid resources during the year are lent out to members within a day *(zero-cash principle).*

Cost-effectiveness and profitability. Village banks and members (as depositors and borrowers) generate minimal transaction costs. The village banks practice a highly cost-effective model adjusted to the small size of villages and the small number of transactions, usually during a two-day period every month. There are no fixed regular costs. Compensations for savers and committee members are paid as dividends out of profits at the end of the bank's financial year. Thus, there is no risk of cost overruns. The village banks in Vientiane Capital are very profitable. Dividends paid to committee members are an attractive source of income, perhaps overly attractive in large village banks. Dividends to savers stand at 10.7%, equivalent to 3% in real terms (adjusted for inflation).

5.1.2 Strengths of networks of village banks

Network structure. In eight of the nine districts of Vientiane Capital, village banks are organized in self-financed, self-managed and self-governed networks; and a network is under preparation in the ninth district. The networks comprise two tiers: zonal and district. Federating the district networks at Vientiane Capital level is being considered; a national federation or apex is not in sight.

Ownership and governance. Network ownership is based on member ownership of the village banks which, in turn, own shares of the respective district network. The networks are self-financed; network expenses incurred by committees at zonal and district level and by the administrative center are paid from a fixed share (2%) of the village banks' profit. The networks are governed by elected committees at zonal and district level and managed by a district center. At the central level, the district network has two organs: a network committee of representatives (e.g., 17 in Saithany District) as governing board, elected by the zonal committees, with delegates from each zone, and an administrative network center.

The networks supervisory bodies. The networks' main objectives are reporting, monitoring and supervision. They also manage voluntary life-insurance funds. The zonal committees are responsible for inspecting the books and collecting financial data and reporting them back to the center. The center staff consolidates the financial data and prepares monthly, quarterly and annual reports – in a timely manner! Center staff inspects dividend payment in village banks. Zonal committees also report problems encountered by the village banks to the district center and committee which decides which steps should be taken. Initiatives to remedy the problems are normally delegated to the zonal committees which, in turn, enter into a dialogue with the village bank committees and, in extreme cases where the committees are not functioning directly, with the general assembly of a village bank.

Dissemination and sustainability. The village banking and related networking model in Vientiane Capital is designed as an integrated, sustainable structure based on principles of self-reliance, self-financing, self-management and self-governance. It was developed with technical assistance by FIAM and subsequently by CODI in cooperation with LWU. The staff and functions of the FIAM project have been transmitted to LCSDPA, a domestic organization. Both CODI and LSCDPA have been involved in disseminating the model of village banking and networking to other provinces, adapting it in various ways to local socioeconomic conditions and donor strategies. Donor support in the provinces usually comprises both technical and financial assistance, with the ultimate objective of sustainability.

5.2 Weaknesses

5.2.1 Weaknesses of village banks

Delays in repayment. On-time repayment does not seem to be a major concern amongst village banks. This might be a relic of savings and loans-in-kind traditions that were prevalent in the early 1990s. In such cases the timing of payments is determined by the rhythm of nature rather than the calendar. Little effort is made to enforce timely repayment. In fact, penalties on overdue loans are a major source of income. This relaxed attitude is backed by the banks' confidence that all loans will eventually be repaid. The overdue loan ratio prescribed by BOL is thus a more realistic performance indicator than the portfolio-at-risk ratio. However, a high overdue loan ratio limits liquidity available for new loans. And it promotes complacency among borrowers, diminishing the productivity of loan usage.

Low rate of capital formation. In the FIAM/CODI model, only 5% of profit is allocated to reserves. This is insufficient to protect the value of the capital against losses due to inflation and against internal crises or external shocks. It is also a restraining factor in any effort to upgrade village banks to formal institutions. It should be noted that that wealth of credit cooperatives in many European countries is due to the fact that, over a century or longer, all dividends have been ploughed back as retained earnings.

The chart of accounts (COA) of village banks does comprise a balance sheet and a separate income statement, but it does not follow BOL's format or international standards. No financial reporting forms are provided to be filled in a prescribed manner. Income and expenditure items are mixed up with the balance sheet. Below are the main deviations from the BOL COA:

- Items are ordered idiosyncratically.
- No salaries and compensations appear as expenditure on the income statement.
- On the basis of the annual income and expenditure statement, net income is calculated and allocated to various categories, comprising dividends to savers, compensations to management and advisory committee members, reserves and funds (as on the BOL COA), and network & supervision costs.
- Income and minor expenditure items on the balance sheet are mixed up both on the liability and asset side respectively.
- The financial year is not standardized and varies depending on the foundation date of each village bank.

Taxation issues. Unregulated village banks do not pay taxes. This will change with licensing and might require some prior adaptation. As remunerations paid to savers and committee members do not appear as cost items in the income statement, they might not be tax deductible. The tax implications of the two models with regard to remunerations, be it as costs or as dividends, need to be studied further in due course.

Manual accounting is not necessarily a weakness in a village setting – it may in fact be a strength under conditions of power failures, lack of IT maintenance and limited numbers of transactions. However, it might be a constraint if monthly or quarterly reporting is required by BOL.

Transactions take place only once a month: cash in on one day, cash out on the next. There are no regular services during the rest of the month. The members could change this; but as they have not done so, we have to assume that there might be a lack of demand for regular services.

5.2.2 Weaknesses of village bank networks

Networking without federating. The networks in Vientiane Capital operate at district level; there is no structure or interest organization beyond this. They are thus not able to speak with one voice to represent their members and express their interests; and there is no systematic data consolidation and reporting at the level of the municipality. This is not surprising, as the networks are still in an early stage developmentally. However, CODI does offer an informal, incipient structure which provides TA to seven districts and is able to provide basic consolidated information (in Lao), but only if requested to do so directly.

Lack of reporting. The district networks do not report to BOL which is why their financial data cannot be consolidated at BOL.

Management and board capacities, and/or the capacities of management and advisory committee members, are limited, leaving ample room for capacity-building. However, capacities are not easily built up just by offering training services. There is no professional permanent management, and the management committee changes every time elections take place; the same applies to the advisory committee members. As a result, professional commitment among both management and advisory committee members is limited. Training providers (like MFC and EBIT Consultancy together with supporting donors) who are trying to build capacity over an extended period thus face constantly changing training scenarios and find it difficult to cater to the needs of both newcomers and more advanced members at the same time.

5.2.3 Wider problem areas in Laos

Lack of stakeholder coordination. During the initial period of microcredit and microfinance development in Laos, UNDP/CDF took the lead and coordinated a Microfinance Roundtable as a communication forum with regular meetings. This came to a standstill when UNDP/CDF pulled out over conflicts concerning a project of its own (1997-2001). The Roundtable was eventually replaced by a Microfinance Working Group, an informal gathering without regular meetings coordinated by two co-chairs[41], with BOL participation. Regretfully, this group has not been active in recent years. Similarly, a microfinance online resource center (www.microfinancelaopdr.org) providing information about microfinance in Laos that was initiated by NERI in the context of the MCBR/NERI microfinance surveys of 2005 and 2006 has not been updated for two years. As a result, there is lack of communication and information among stakeholders. At the turn of 2009 to 2010, steps were being taken to revive the Microfinance Working Group.

41 Timo Hogenhout, microfinance consultant and Somphone Sisenglath, director of Microfinance Center, a leading private training and consulting firm

6. Options for village banks in Vientiane Capital

6.1 Presentation of options

Option 1: Establishment of a stakeholder communication forum at the VientianeCapital level

Vientiane Capital has the strongest village bank network organizations in Laos. So strong in fact they are even evolving into representative and supervisory bodies. Up to now, none of the village banks in the municipality has registered and none of the stakeholders has taken steps to register village banks as NTMFs or as licensed MFIs.

Recommendations. We recommend establishing a stakeholder communication forum at the Vientiane Capital level:

- The forum could include the following participants:
  - village bank network organizations in Vientiane Capital
  - BOL
  - LWU
  - local government
  - service providers (CODI, FIAM)
  - donor agencies
- The VB district network centers, with assistance by LWU and service providers, establish a federation or representative body at Vientiane Capital level.
- The VB federation or representative body together with BOL, LWU, local government and service providers establish a communication forum and engage in regular dialogue.

- As long as a federation or representative body does not exist, representatives of the district networks participate in the forum directly.
- Representatives of network organizations could be the head of/advisor at the network center and the chairperson of the district network committee.
- Organization: The forum is governed by a committee of stakeholders, and managed by an executive committee which is supported by a permanent secretariat.
- The forum appoints task forces or working groups for specific tasks.
- The forum establishes a task force for the preparation and implementation of appropriate prudential regulation.
- The forum receives technical assistance through one of the donor agencies in Laos.

Option 2: Village banking networks

Village banking networks at district level which follow the village banking principles of self-financing, self-management and self-governance were first established in Vientiane Capital in 2003. In cooperation with LWU, networks were first initiated by FIAM in Saithany District and subsequently by CODI in seven other districts. A network is expected to be set up in the remaining district in 2010. The networks are self-reliant organizations that are owned, managed and financed by the village banks in a given district. Since they have no legal status, the networks need to obtain one in order to secure their sustainability, a move that would endow them with a function within BOL's regulatory framework.

There is only scant information; no systematic study of the networks exists. The network and network centers are at various stages of development. While Saithany District has served as a model, it is not clear to what extent the networks in the other districts mirror the zonal and district network and district center structure of Saithany and how well they function. We may assume that the more recent ones in particular might be quite rudimentary structures. There is no network or network federation at the level of Vientiane Capital. The district networks, or at least the one in Saithany District (the only one on which we have collected basic information), offer the only system designed to actually carry out basic support functions for village banks on a sustainable basis: registration, guidance, monitoring, reporting and supervision. They thus carry out functions informally, although these should be executed formally. From a demand and member perspective, the village banks recognize their networks as representative bodies and submit to their authority as an informal supervisor (informally sanctioned by LWU). This framework could initiate a process of communication regarding the reformulation of regulations and the practical implementation of registration, licensing, reporting and supervision of village banks, along with guidance and capacity-building.

Recommendations: We suggest that donors focus their support on strengthening sustainable networking structures as self-organized instruments of village banking development in concertation with LWU and BOL, with a view to promoting a properly registered, licensed and supervised system of village banks in Vientiane Capital by:

- Establishing a communication forum as described under Option 1 with several task forces to examine the appropriateness and feasibility of the options and recommendations presented, to facilitate donor linkages, initiate feasibility studies, prepare business plans and monitor their implementation
- Strengthening existing support agencies (e.g., initiated by FIAM and CODI) in Vientiane Capital
- Strengthening VB district networks as self-organized and self-reliant business associations, service providers and informal monitoring & supervisory bodies
- Initiating a network or federation of district networks at Vientiane Capital level as an advocacy agency for the village banks and their district networks
- Building network services or subsidiaries at district or Vientiane Capital level such as:
    - Training services (in cooperation with existing training providers)
    - Central fund(s) for liquidity exchange and refinancing
    - Auditing services
- Facilitating appropriate registration, licensing and legal forms for the networks (most probably as *associations* under association law) and their subsidiaries
- Facilitating a revision of the regulatory framework for village banks
- Facilitating the process of bringing village banks under an appropriate regulatory framework
- Launching the process of communication, network strengthening and licensing facilitation in Saithany District, since this district has the strongest network and village banks.

This would require initial funding by donor agencies as it will take time for the networks to become fully operational and sustainable.

Option 3: Village-based NDTMFIs

Village banks in Vientiane Capital have evolved since 1998, and now serve more than 90% of villages. The focus of operations is on the village community. Village banks do not wish to branch out or merge with neighboring village banks, which thus limits the possibility of "economies of scale". The village banks in Vientiane Capital have developed a unique operating system; all are profit-making. In a survey among 40 village banks in Saithany District, the respondents stated emphatically that they were very satisfied with the existing set-up and would by no means want to change the existing system. At the same time, they were not aware of the details of the new regulation and knew nothing about the advantages and changes licensing would entail. Against this backdrop, a two-way process of confidence-building and learning might be helpful to enable the village banks to become familiar with the new regulation and with BOL as an institution and perhaps even come to recognize it as a well-meaning partner. At the same time, BOL would get to know the existing village banking system, its strengths and its need for improvement. The forum proposed under Option 1 would play a crucial role in this process.

Recommendations. We therefore propose an evolutionary and interactive approach to prudential regulation, building on the existing village banking system in Vientiane Capital. Such a process would best be initiated by registering all village banks in Vientiane Capital as NDTMFIs with BOL through their networks in the course of 2010, without any expectations or pressure with regard to transformation into an SCU or DTMFI during this year. The forum described under Option 1 would facilitate implementation of a participatory process possibly involving the following steps:

- The Vientiane Capital forum re-examines the regulation for NDTMFIs, particularly with respect to maximum loan size (10m Kip), maximum deposit balance per village bank (200m Kip) and maximum deposit size per single depositor (10m Kip).
- The forum agrees on an appropriate name for MFIs that are registered with BOL but not prudentially regulated; the name should indicate that these MFIs are authorized to collect voluntary savings (up to a certain amount).
- The forum agrees on a COA adjusted to the specifics of the village banks and approved by BOL.
- The village banks adjust their financial year to the calendar year and report annually to BOL through their network centers.

- For annual reporting and tax purposes, dividends to savers and committee members may be recalculated at year's end as interest expenses and compensations for committee members respectively.
- The forum, in close association with the district networks and zonal committees, discusses strategies for improving on-time repayment, e.g., by offering incentives for timely repayment, and guidance to village bank committees.
- All village banks register as NDTMFIs with BOL through their networks as facilitators.
- The village banks' annual reports are monitored by the district network centers and forwarded to BOL.
- BOL might recognize the district networks as monitoring agencies.
- Once a federation of district networks is established, its role in reporting and monitoring is agreed on with BOL.

Option 3A: District network-based NDTMFIs

As an alternative to Option 3, the forum of district networks, BOL and other stakeholders may decide, with BOL approval, that all village banks should register with their respective district networks and that the district networks register as NTMFIs with BOL, submitting consolidated annual reports. This might be a temporary solution for a transitional period until a satisfactory solution has been found for the village banks themselves. However, it should be noted that this would distort the nature of the district networks which have not been designed as financial institutions.

Recommendations. As the existing networks of village banks in Vientiane Capital are of recent origin, recommendations can only be procedural and exploratory:

- The forum examines the feasibility of registering the VB district networks as NTMFIs and initiates the implementation of any recommendations it might have.

Option 4: Village-based SCUs

Village banks and SCUs share a common philosophy: both are member-controlled and follow the democratic principle of one member, one vote; savings are the main source of funds; the general assembly of members is the highest authority presiding over policy, management and governance. And yet, no effort has been made to build a modern credit cooperative system linking these 5,000 or so village banks or funds as they evolved over the past twenty years. This is only partially due to the negative image of cooperatives, a term and institution associated with the collapse of the former command economy, including the credit cooperative sector.

Village banks have not exactly fallen over themselves to register as regulated SCUs. In fact, only a minute number of regulated SCUs exist in Laos: eleven out of an estimated 5,000 mostly semi-formal MFIs (village banks or funds). Not all of the eleven are licensed under the SCU regulation of 2008; e.g., Naxaython RDC is still registered under the old regulation. Moreover, not all SCUs are performing well. (See chapter 1.2).

Most village banks would meet the regulatory requirement of ten founding members and 100 initial members, though payment of the minimum share might be an issue. External auditing services could be provided by the respective district networks. Several provisions in the SCU regulation would require adjustments by the village banks: a minimum registered capital of 100 million Kip (which is zero in village banks), a liquidity ratio of 20% (kept at an absolute minimum) and a maximum NPL ratio of 5%. Paid-up capital formation could be arranged by members allocating the membership fee and part of the dividend to share capital until the (possibly reduced) required minimum is reached. Credit discipline, bringing the NPL ratio below 5%, would probably be a greater challenge, but one to which village banks should respond in any case.

On the whole, village banks and credit cooperatives (or unions) share an affinity; this is corroborated by the fact that the village banking system in Vientiane Capital has been shaped after international cooperative regulations. Also most of the few SCUs that do exist are reportedly former village banks that have become licensed institutions. If Naxaython RDC may serve as a model, then larger cooperatives (in the case of Naxaython RDC covering 52 villages) would stand to gain in terms of their management professionalism. There is a definite preference among village banks for single-village MFIs, without branches or coverage of several villages. It appears that the SCU regulation is designed for a different size of financial institution, with a branch network and a wider outreach at district or provincial up to national level. At the same time, village banks in Vientiane Capital appear to be markedly opposed to registering as SCUs: partly out of fear of regulatory impositions, partly because of the negative image cooperatives have in Laos.

Recommendations: A historic chance was missed in 1998 when FIAM and subsequently CODI helped LWU establish village banks. An appropriate regulatory framework could have been established for single-village SCUs (as was the case in Germany, the Netherlands, India and many other countries); and all newly founded village banks could have been licensed as SCUs.

In the given situation we recommend the following:

- The VB district network centers, with assistance from LWU and service providers, establish a communication forum with BOL (as outlined under Option 1)
- In order to learn from international cooperative experience, BOL together with the communication forum, establishes a task force and examines the approach taken by SBV, the central bank of Vietnam, in designing, regulating, establishing, promoting and supervising a credit cooperative system (comprising 1,015 PCFs with 1.35 million members as at 2008). The objective would not be to replicate the Vietnamese model; such replication might convert *best practices into worst practices* if applied mechanically. Rather, the purpose of exposure visits, or a consultancy by the Central Fund of People's Credit Cooperatives of Vietnam (CCF), would be to promote understanding of the complex process of building a successful credit cooperative system.
- BOL could also benefit from the cooperative experience had by Germany, the Netherlands and Canada or any other countries, and from support by their cooperative development organizations (DGRV, Rabobank Foundation and DID, respectively – all three involved in either Laos or Vietnam or both) – provided this assistance is applied to systems development rather than to single institutions.

Option 4A: District network-based SCUs

As an alternative to Option 4, the forum proposed under Option 1 could consider registering the existing VB district networks as SCUs, with village banks either as branches or members. However, at present this would be a rather artificial construct. As they emerged, the district networks were not intended to be MFIs, but rather umbrella organizations with a mandate to provide guidance, monitoring and supervision for village banks within the network, albeit initially without formal approval. Of the existing two legal forms, SCUs (comprising village banks as founding members with equal votes) would be more appropriate than DTMFIs, which are controlled by share capital rather than individual or corporate members, which makes them more attractive to private investors. If district networks or a (as yet non-existent) network federation of Vientiane Capital should decide to establish a subsidiary for liquidity exchange and refinancing, an appropriate legal form for such an apex fund would have to be found.

Recommendations. As the existing village bank networks are of recent origin, recommendations can only be procedural and exploratory:

- The forum examines the feasibility of registering the VB district networks as SCUs and initiates the implementation of any recommendations it may have.
- The forum examines the feasibility of apex funds as subsidiaries of the district network of an apex fund operated by a network federation at Vientiane Capital level and initiates the implementation of any recommendations it may have.

Option 5: DTMFIs

There is nothing to suggest that any village bank has registered as a DTMFI. Out of 16 licensed MFIs, only five are registered as DTMFIs. High operating costs, poor performance, lack of self-reliance and, at least in one prominent case in Vientiane Capital, a combination of high losses with high interest rates, do not make a convincing case for village banks and their network associations to consider DTMFI a feasible legal form. DTMFIs are large institutions by legal definition, with a minimum capital requirement of 1 billion Kip: this is far beyond the capacity of village banks – even in Saithany, the district with the most prosperous village banks in Vientiane Capital. By necessity, DTMFIs extend their outreach to a large area, incurring high transaction costs in the process; they cannot subsist in a single village. DTMFIs may be attractive for private investors, but not for village banks. Apart from their minimum size, the fundamental incompatibility of the DTMFI and the village banking models in Vientiane Capital derives from their differences in ownership and governance: DTMFIs are owned and governed by private investors according to their share capital (among them at least one *major shareholder*). In contrast village banks are democratic institutions which are saver-driven, member-controlled (each member with the same vote regardless of the amount of savings) and community-governed. Dividends in DTMFIs are paid to shareholders, in village banks they are paid to savers.

Recommendations. The shareholder-based DTMFI model and the member-based village banking model of Vientiane Capital are incompatible:

- No attempt should be made to register village banks or their network associations as DTMFIs.

Option 6: Delegated supervision implemented by village banking networks

Village bank networks in Vientiane Capital provide guidance, monitoring, reporting and supervision services to their member institutions. The network in Saithany District, established in 2003, is the one which is most advanced. By the end of 2010 presumably all village banks in the nine districts of Vientiane Capital will be covered; services are evolving.

Recommendations: Learning from the experience of countries with systems of delegated supervision involving large numbers of local financial institutions, we recommend:

- Establishing a communication forum task force (see Option 1) to initiate a dialogue between BOL, LWU, district networks and service providers on delegated supervision
- Examining the feasibility of a system of delegated supervision, comprising:
  - BOL as the ultimate financial authority,
  - auditing services by village bank networks as implementing agencies on behalf of BOL,
  - possibly a federation of networks in Vientiane Capital with coordinating functions
- Establishing auditing services (or auditing federations or agencies as subsidiaries) as network supervisory organs

We further recommend that

- The networks facilitate village bank registration as NDTMFIs
- The networks provide services to NDTMFIs, such as reporting and monitoring, guidance and supervision (over and above what the regulation for NDTMFIs presently requires)
- The networks facilitate the transformation of qualified village banks into prudentially regulated MFIs (such as SCUs)
- Networks build up their capacity building and their auditing services
- Networks supervise auditing of prudentially regulated village banks on behalf of BOL

and, finally, we are in favor of

- Pilot-testing delegated supervision in Saithany District
- Possibly learning from experience in Germany with banking supervision delegated by Bafin and Bundesbank (as financial authorities) to *audit-*

ing federations of large numbers of savings banks and cooperative banks, historically preceded up to 1934 by self-regulation and self-supervision through the respective network agencies (Seibel 2003).

Option 7: Village banks facilitate access to bank loans

In 2006-07 there were 88,045 registered enterprises in Laos, on average eight per village. 29.5% of them are in Vientiane Capital. The majority of the enterprise sector in Laos consists of private micro and small enterprises and unregistered household businesses or income-generating activities. 70% of employment is in agriculture, 11% in manufacturing. 97% of manufacturing enterprises are small-scale, with less than 10 employees.[42]

In 2007 GTZ surveyed 490 enterprises, or 5.9%, out of a total of 8290 registered enterprises (21% in Vientiane Capital) in 15 target districts in five provinces[43]. Microenterprises are rarely registered; hence the sample is weighted towards larger enterprises. In terms of size, 19% of the sample enterprises were microenterprises (1-2 employees), 62% small enterprises (3-19 employees), 15% medium-scale enterprises (20-99 employees) and 4% larger enterprises (100 and more employees). Closure rates are high. Some 4,198 enterprises were registered in 2005 in the 12 sample districts in four of the five provinces; 2,895 closures were reported as of 2007, equivalent to 69% (not exactly evidence of higher sustainability than among informal enterprises).

A total of 46% of the sample enterprises took out a loan in 2007, about the same as in 2005 (48%). The respective percentages by enterprise size are as follows: microenterprises 35%, small enterprises 45%, medium enterprises 63% and large enterprises 55%. 2007 marked a shift from supplier credit to bank loans. Reportedly, banks accounted for the vast majority of loans, namely 69%; microcredit schemes accounted for only 1.5%, among them presumably village banks (not specifically mentioned). Family members and relatives accounted for 12%, friends for 6% and moneylenders for 9%.

From 2005 to 2007 the number of bank-sourced loans increased dramatically from 4% to 69%, while reported supplier credit fell from 52% to 2%. GTZ (2008:109-110) suggests that this might “reflect(s) the ongoing improvements and reforms in the banking sector, including the promulgation of the

42 GTZ 2008: 28, 18

43 Vientiane Capital, Champasack, Luangprabang, Luangnamtha, Savanakhet. This is not a random sample; in each province three districts were selected: the central district, a peri-urban district and a more rural district accessible by road.

Commercial Bank Law in early 2008 and ongoing efforts by the Bank of Lao to improve portfolio quality at the state-owned commercial banks." In 2007 bank loans dominated in number (and almost certainly even more so in volume) across all categories of enterprise size, most pronounced in large enterprises (91%) and medium enterprises (75%); the respective percentages for micro and small enterprises were 71% and 66%.

No details are known about the size of loans obtained, only the scale of loan demand. 63% of the enterprises stated they would need a loan to expand their business whereby demand varied little across all sizes of enterprise. The average loan size reportedly needed was 8.6 billion Kip (double the average of 4.3 billion in 2005); we may assume that actual loans received were much smaller. Depending on enterprise size, the loans desired ranged from 289 million Kip among microenterprises (77 million Kip in 2005) and 1.0 billion Kip among small enterprises (1.8 billion in 2005) to 22 million among medium enterprises (3.9 billion in 2005) and 105 billion among large enterprises (42 billion in 2005). The much larger lending volumes demanded in 2007 reflect the banks' new outreach policy. (GTZ 2008: 109-113)

Most of the registered micro and small enterprises in the sample are obviously in a different league from those served by village banks (or VSCGs). Even if we assume that average loans to registered microenterprises may be around or below 100 million Kip and small enterprise loans below 500 million Kip, they are still far above the average loan of around 10 million Kip disbursed per borrower in 2008-09 in Saithany District, or the 6 million Kip in seven other districts of Vientiane Capital and 3-4 million Kip in a further four provinces (where CODI supports village banks). However, maximum loan sizes are a multiple of these amounts and may well be required as a source of finance for registered micro and small enterprises, and, most importantly, for start-ups.

Recommendations: Once micro or small enterprises grow beyond a certain size, their credit needs surpass the capacity of village banks. Although village banks may still provide short-term working capital loans; larger and longer-term loans would have to be accessed from banks. Here the village banks, through their networks or associations and service providers, could help facilitate access. As for the customers themselves, as members of a village bank, they have a track record as savers and borrowers, which could be documented to help overcome the information asymmetry between bank and borrower. Customer awareness of the importance of a track record might also mobilize them to make repayments on time. Establishing such a system would require a special effort by the village bank networks and their technical assistance providers. We therefore recommend:

- Establishing a stakeholder forum task force to examine the feasibility of a village bank referral service for loans from larger banks
- Building capacity in VB district networks to organize such a referral service
- Monitoring bank referrals through the stakeholder forum or a federation of networks in Vientiane Capital.

Option 8: Bank linkages for liquidity management and refinancing

Village banks experience seasonal liquidity shortages and surplus situations. Being seasonal, they cannot be resolved through liquidity exchange within village bank networks. Moreover village banks are unable to meet the demand for loans exceeding their own resources.

Recommendation: Once village banks are registered with BOL, seasonal liquidity mismatches as well as overall shortages or surpluses of liquidity of village banks may be resolved through bank linkages. The forum, under BOL leadership, could play a vital role in establishing a system of bank linkages:

- Examine the feasibility of bank linkages for liquidity management, depositing surplus funds and refinancing
- Facilitate business relations between registered village banks and commercial banks.

6.2 Assessment of options

(1) Establishing a stakeholder communication forum in Vientiane Capital

Vientiane Capital has VB network organizations with evolving services covering all eight, and by the end of 2010 presumably all nine, districts, with a total of around 450 village banks. It is assumed that more than 150 of these village banks have over 200 million Kip in savings. We propose establishing stakeholder communication forum in Vientiane Capital comprising the village bank network organizations and BOL, together with LWU, local government and the service providers, supported by donor agencies. The forum should examine all options presented below and initiate appropriate action.

(2) Village banking networks

Village banking networks, which have evolved in Vientiane Capital since 2003, are self-reliant organizations that are owned, managed and financed by the village banks in a given district. To date they have been operating as informal organizations. Their functions include registration and reporting within the network, monitoring, guidance and supervision. We propose that donors focus their support on strengthening the emerging networking structures as self-organized instruments of village banking development. Once legally registered and recognized as partners, they could facilitate the promotion of a properly regulated and supervised system of village banks in Vientiane Capital.

(3) Registration of village banks as NDTMFIs

Village banks in Vientiane Capital are internally registered and monitored by their respective network organizations, which first appeared on the scene in 2003; to date none is registered with BOL. As a first step, we propose that the forum facilitates the registration of all village banks as NDTMFIs through their network organizations. The networks will also provide reporting and monitoring services as well as guidance and supervision, over and above BOL stipulations for NDTMFIs. Special efforts should be made to establish an atmosphere of mutual learning and confidence-building between the village banks and BOL.

The forum could also examine the feasibility of registering the network organizations as NDTMFIs with village banks as members. However, this would lead the networks in a different direction, as they have not been designed as financial institutions, and their financial activities would have to be newly developed. This might also create a conflict of interest between the networks' guidance and supervision functions and their new financial operations. This is therefore not recommended.

(4) Licensing of village banks as SCUs

Both village banks and SCUs share a common philosophy, being member-owned and member-controlled. However, the regulatory framework for SCUs is designed for larger organizations, covering far more than a single village. We recommend re-designing the SCU regulation to fit small single-village MFIs (as was the case in many countries of Europe), particularly with regard to minimum capital requirements. At present, village banks strongly object to major changes to their system and, for historical reasons, to the cooperative model. The forum and the networks could play a crucial role in the adaptation of the revised regulation and in promoting acceptance of a suitably adapted regulation by the village banks.

SCUs have great potential in Laos, despite past negative experience with cooperatives. We therefore suggest that the communication forum establish a task force to examine successful international cooperative experience in credit cooperative development, particularly in Vietnam, in order to foster an understanding of the complex process involved in building a successful credit cooperative system. Vietnam is also a country that has overcome the negative image resulting from the collapse of the credit cooperative sector.

The learning process could be backed by cooperative development organizations, such as DGRV, Rabobank Foundation and DID, all three of which are engaged in either Laos or Vietnam or both.

The forum should also examine the feasibility of registering the network organizations as SCUs. However, as indicated above, this would turn them into financial institutions, which they were not intended to be. There is also no valid reason for establishing large institutions which would incur substantially higher administrative costs and possibly make losses, especially since the existing village based institutions are very cost-effective and profitable. The village banks prefer single-village MFIs – we have no reason to disagree.

(5) Licensing of village banks as DTMFIs

The DTMFI and the village banking model as it has evolved in Vientiane Capital are fundamentally incompatible: DTMFIs are owned and governed by private investors according to their share capital and are driven by the profit motive whilst village banks are democratic institutions which are saver-driven, member-controlled and community-governed. This incompatibility also pertains to DTMFIs as a legal form for networks that were not designed as financial institutions. By legal definition, DTMFIs are large institutions, with a minimum capital of 1 billion Kip – far beyond the capacity of village banks. DTMFIs extend their outreach to a large area, incurring high transaction costs; they cannot subsist in a single village. DTMFIs may be attractive for private investors (if they succeed in turning a profit), but not for village banks or their networks.

(6) Delegated supervision implemented by village banking networks

Village bank networks in Vientiane Capital are self-organized supervisory agencies offering a growing number of services to their member institutions. Therefore, we propose establishing a system of delegated supervision, building on the existing networks and strengthening them as effective supervisors under the ultimate authority of BOL. With support from donor agencies experienced in delegated supervision, pilot-testing should start in Saithany District, since this district has the largest number of village banks and the strongest network.

(7) Village banks facilitate access to bank loans

Village banks have a limited capacity for extending larger-scale loans to small and medium enterprises. Capitalizing on the track record of members requiring larger loans, VB district networks, under the guidance of the stakeholder forum, should organize a referral system in which village banks refer members needing larger loans to bigger banks.

(8) Bank linkages for liquidity management and refinancing

Village banks experience seasonal liquidity shortages and surplus situations which cannot be resolved through liquidity exchange within networks. They also are unable to respond to demand for loans that exceed their own resources. The stakeholder forum, under the leadership of BOL, should examine the feasibility of bank linkages and, in due course, facilitate business relations between registered village banks and commercial banks.

7. Roadmap for village banks in Vientiane Capital in the years ahead

Based on the analysis in chapters 2-5 and the discussion of options in chapter 6, we propose the following steps and strategies.

A. Establishment of a stakeholder communication forum in Vientiane Capital

As a first step, a forum could be established at the level of the municipality. This forum could consist of VB district networks, BOL, local government and LWU, together with service providers and donor agencies involved in the development of village banks and their networks. The forum's objective would be to initiate a communication process with the main actors involved in the village bank development process, particularly the VB district networks as evolving representative bodies, and to start a participatory process.

B. Strengthening district village banking networks

The emerging district village banking networks are designed as self-reliant and sustainable self-help organizations. They have a crucial role to play in the development of the village banks, one that requires further strengthening. Support should focus on building up the capacity of the zonal and district committees and district center management and nurturing their ability to carry out or promote core network functions: registration of village banks within the network, reporting, monitoring, guidance and supervision. In due course, support might also include the establishment of special services or subsidiaries for training, liquidity exchange & refinancing, and auditing – either at the district or municipal, i.e. Vientiane Capital level. Efforts should be made to have the networks legally registered and recognized as facilitators of a process aimed at establishing a properly regulated and supervised system of village banks. Piloting should start in Saithany District.

Capacity building should also include the establishment of a federation of district networks at the level of Vientiane Capital as an interest organization representing all village banks in the municipality.

C. Registration of all village banks in Vientiane Capital

Under the forum's guidance, the district networks should be enabled to facilitate the registration of all village banks as NDTMFIs – as an initial step prior to licensing. Besides registration, the networks will also provide monitoring and guidance services. The term Non-deposit-Taking MFI should be revised to indicate that all village banks mobilize deposits.

Furthermore, the forum should also examine the feasibility of registering network organizations as NDTMFIs, bearing in mind, however, that the networks have not been designed as financial institutions. Should networks decide to perform financial functions (e.g., liquidity exchange), these should be placed in a subsidiary.

D. Licensing of village banks

Guided by the forum, network capacity should be built up to facilitate village bank adjustment to the regulation and to the process of SCU registration. A major challenge for the networks is the village banks' resistance to cooperatives, partly for historical reasons deriving from the collapse of the credit cooperative system under the former command economy, and partly out of fear of having an unwanted (though as yet unfamiliar) model imposed on them. The forum should also examine the feasibility of registering network organizations as SCUs, again bearing in mind that, as noted above, the networks have been designed as associations and not as funds or financial institutions.

Building a self-reliant credit cooperative sector in Laos goes beyond providing a regulatory framework and registering village banks as SCUs. In this context, the forum should initiate an exposure program in Vietnam in order to foster understanding of the complex process involved in building a successful credit cooperative system. The learning process should be backed by international cooperative development organizations such as DGRV, Rabobank Foundation and DID.

E. Establishing a system of delegated supervision through village bank networks

Once village banking networks are fully operational, village banks have been registered and the process of licensing started, a system of delegated supervision can be installed. Guided by the forum, the district networks and their yet-to-be-established specialized auditing services should be empowered to supervise the village banks on behalf of BOL. Support should be provided by donors with experience in delegated supervision. Piloting would be best in Saithany District.

F. Establishing relations with commercial banks

Village banks should facilitate access to bank loans for any of their members requiring larger-scale, small- and medium-enterprise loans. District networks, under the guidance of the forum, should organize a referral system by which village banks refer members with a good track record to bigger banks.

Bank linkages should be established by village banks for the purpose of liquidity management during seasonal liquidity surplus and shortage periods and for refinancing.

G. Ancillary activities

The Microfinance Working Group, a successor to the Microfinance Roundtable of the 1990s, needs to be revitalized as an informal gathering for the exchange of information and the coordination of interventions in the microfinance sector at national level.[44]

Policy seminars under the auspices of BOL should be supported by a secretariat or a secretary-general to ensure the implementation of action plans to follow up the results of the seminars. The viability of an organizational affiliation between the Microfinance Working Group and the proposed secretariat of the policy seminars, both of which have a national outlook, and their relationship with the proposed Stakeholder Communication Forum in Vientiane Capital should be examined. An appropriate coordination and cooperation framework should be installed, as seen fit.

44 It appears that an initiative to revive the Working Group got underway in January 2010.

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Annex 2: Lao People's Democratic Republic: Country Economic Indicators (2005–2009)

(Percentage of GDP, unless otherwise indicated)

Item	Fiscal Year				
	2005	2006	2007	2008	2009 Projected
A. Income and Growth					
1. GDP per Capita ($, current)	492.4	568.3	672.6	840.0	866.0
2. GDP Growth (%, in constant prices)	7.1	8.1	7.9	7.2	5.5
a. Agriculture	2.5	3.5	6.2	2.0	2.5
b. Industry	15.9	21.5	6.5	10.0	8.0
c. Service	6.7	5.3	12.1	9.7	5.0
B. Saving and Investment (current and market price, % of GDP)					
1. Gross Domestic Investment	30.2	31.1	39.7	37.1	35.2
2. Gross National Saving	11.7	20.3	21.9	18.2	16.6
C. Money and Inflation (annual % change)					
1. Consumer Price Index	7.2	6.8	4.5	7.6	0.7
2. Total Liquidity (M2)	8.1	17.2	38.7	18.3	23.0
D. Government Finance (% of GDP)[a]					
1. Revenue and Grants	13.2	14.6	15.8	17.8	13.4
2. Expenditure and Onlending	17.6	18.4	18.6	20.9	18.4
3. Overall Fiscal Surplus (Deficit)	(4.4)	(3.8)	(2.9)	(3.1)	(5.0)

Item	Fiscal Year				
	2005	2006	2007	2008	2009 Projected
E. Balance of Payment					
1. Merchandise Trade Balance (% of GDP)	(19.0)	(12.8)	(20.0)	(21.9)	(20.0)
2. Current Account Balance (% of GDP)	(16.9)	(10.3)	(16.2)	(17.3)	(14.6)
3. Merchandise Export ($) Growth (annual % change)	30.1	62.6	16.6	24.1	(21.0)
4. Merchandise Import ($) Growth (annual % change)	20.3	25.1	35.7	30.6	(13.5)
F. External Payments Indicators					
1. Gross Official Reserves (including gold, $million by month of current year's imports of goods)	2.8	3.2	3.9	3.4	3.5
2. External Debt Service (% of exports of goods and services)	8.1	5.7	12.5	10.3	11.1
3. Total External debt (% of GDP)	77.1	63.1	59.1	53.1	54.5
G. Memorandum Items					
1. GDP (current prices, kip billion)	29,663.0	35,983.0	40,858.0	46,700.0	49,269.0
2. Exchange Rate (kip/$, average)	10,642.0	10,415.0	9,694.0	8,707.0	8,550.0
3. Population (million)	5.7	5.8	5.9	5.9	6.0

( ) = negative, GDP = gross domestic product.

a Based on fiscal year (October to September).

Source: Asian Development Outlook, IMF Article IV Consultation, Department of Statistics, Bank of Laos and Ministry of Finance.

Annex 3: Microfinance regulation: Summaries and overviews

3.1 Non-Deposit-Taking Microfinance Institutions (NDTMFIs)

Summary

Requirement to register	Any and all microfinance activities by groups, individuals or legal entities
Required registrations	With BOL and relevant government authorities
Resource mobilization	Compulsory and voluntary deposits by members Loans or grants from Lao and foreign entities
Regulation	• Micro-loans only, not exceeding 10m Kip • Voluntary deposits not exceeding 200m Kip in aggregate and 10m Kip per depositor unless authorized by BOL • Quarterly review of all loans, provisioning as prescribed • Annual reporting to BOL
Conversion requirement to a prudentially regulated MFI	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip

Non-Deposit-Taking Microfinance Institutions regulation: overview

Regulation No. 02/BOL	**20/06/2008 (EN)**
3. Requirement to register	Any organization, group or enterprise that carries out microfinance activities, including village banks, savings groups, village funds, development funds and others
4-5. Required registrations	Certification of registration from BOL Registration with the relevant government authorities
10. Registration fee	200,000 Kip
13./14.d. Capital	No minimum capital requirement Loans or grants from LAO PDR. foreign organizations and other legal entities subject to BOL approval

14. Financial services to members only	Micro-loans up to 10m Kip, compulsory deposits, voluntary deposits not exceeding 200m Kip in aggregate and 10m Kip per depositor unless authorized by BOL
14.Other financial activities	Mobilizing loans or grants from Lao and foreign entities Deposit funds with BOL or commercial banks
16. Loan classification and provisioning	Quarterly review of all loans. Provisioning: Overdue 30-90 days: 25% Overdue 31-180 days: 50% Overdue >180 days: 100%
18. Accounting and reporting	Chart of accounts provided by BOL Annual reporting (balance sheet, income statement, loan portfolio report, loan classification report)
20. Conversion requirement to a prudentially regulated MFI)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
75. Implementation: Compliance requirements	Any state, provincial, district, village level or group organization, individual, international or private organization or enterprise currently carrying out microfinance or similar activities or planning to do so is required, within a period of 12 months from the effective date of this regulation, to comply with the requirements as stipulated in this regulation Penalties for non-compliance: 100,000 Kip per day.
76. Effectiveness	Replacing Regulation No. 10/BOL, effective as from the date of its signature

Source: www.bol.gov.la/english/microfinanceeng.html; http://www.bol.gov.la/english/mf_reg02eng.pdf

3.2 Savings and Credit Unions (SCUs)

Summary

Conversion requirement to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
Location and outreach	National, members only
Establishment requirements	10 founding members and 100 initial members; or 250 members and voluntary deposits of 300m Kip
Voting rights	One member, one vote
Resource mobilization	Member deposits, loans or grants from Lao and foreign entities
Prudential regulation:	• Minimum registered capital 100m Kip • Provisioning for loans overdue >30, >90, <180 days; 1% on performing loans • Maximum NPL ratio: 5% of loans outstanding • Write-offs: loans overdue >180 days • CAR 12% (risk-weighted) • Liquidity ratios: cash in hand 4%; overall 20%
Auditing and supervision	Internal and external auditing, supervision by BOL Quarterly and annual reporting

Penalties for non-compliance	100,000 Kip per day to SCUs incl. managers or employees Suspension and cancellation of license
Interest rate restrictions	None

Savings and Credit Union (SCU) regulation: overview

Regulation No. 03/BOL	**03/06/2008 (EN)**
Conversion requirement to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip (NDTMFI regulation Art. 20)
1. Terms: Microloans Capital: Compulsory deposit:	Up to 10m Kip Initial capital, regulatory reserves, grants and retained earnings Condition for receiving a loan, a percentage or nominal amount
3. Legal status	Financial cooperative licensed by BOL
4. Location	Allowed to open a head office, branches or service units throughout the entire country. Subject to prior approval by BOL
5. Establishment requirements	• Either 10 founder members and 100 initial members who pay the minimum share; • or 250 members and voluntary deposits of 300m Kip. • Minimum registered capital: 100m Kip • No individual with his/her relatives is allowed to own more than 10% of the initial capital • BOL checks educational background and experience in finance, banking, accounting, auditing and management
14. Licensing fees	Application fee: 500,000 Kip Issuance fee if registered capital is: >100m up to 300m: 1m Kip >3m 1.5m Kip
15. Annual supervision fee	500,000 Kip
17. Minimum initial capital	100m; maximum share size 100,000 Kip
19. Depositor protection	Member of the Depositors' Protection Fund (fee based on total deposits)
21. Organisation	General assembly of members as the highest body, board of directors (5), audit committee (3), credit committee (5), manager
23. Resolutions of the general assembly	One member, one vote; cast by secret ballot
37. Financial services to members only	Loans, voluntary and compulsory deposits, payment and transfer services within the country, insurance as a broker
37. Other financial activities	Mobilize capital in the form of loans or grants (not equity!) from Lao PDR and foreign organizations or legal entities Deposit funds with any commercial banks
38. Restrictions	Leasing; dealing in precious metals or commodities, real estate and derivatives; payment services through checking accounts; foreign exchange
44. Credit to related parties	Loans outstanding to related parties shall not exceed 5% of capital to each related party and 25% on aggregate

45. Loan classification and provisioning	Performing loans: 1% Overdue 30-90 days: 25% Overdue 31-180 days: 50% Overdue >180 days: 100% NPL limit 5% of loans outstanding
48 Write-offs	Loans overdue >180 days
49. CAR (risk-weighted)	12%
50. Liquidity ratios	Cash in hand 4%.; overall 20%
54. Regulatory reserve	5% of net profit up to 20% of registered capital
56. Taxation	Taxable according to the prevailing tax law
57. Auditing	Internal audits by internal auditor or audit committee External audits by external auditors and examination by BOL
58. Accounting and reporting	Accounting system and chart of accounts by BOL Quarterly reporting: Balance sheet Income statement Loan and deposit report Loan classification report Annual reporting: 6 additional reports
72. Penalties for non-compliance	100,000 Kip per day to SCUs incl. managers or employees Temporary suspension and cancellation of licence
75. Implementation	Any state, provincial, district, village level or group organization, individual, international or private organization or enterprise currently carrying out microfinance or similar activities or planning to do so is required, within a period 12 months from the effective date of this regulation, to comply with the requirements as stipulated in this regulation Penalties for non-compliance: 100,000 Kip per day
76. Effectiveness	Replacing Regulation on Cooperatives Number 02/BOL dated 19/11/94 and Regulation on Pilot SCUs Number 256/BFSD dated 12/05/04, effective as from the date of its signature

Source: http://www.bol.gov.la/english/mf_reg03eng.pdf; www.bol.gov.la/english/microfinanceeng.html

3.3 Deposit-taking Microfinance Institutions (DTMFIs)

Summary

Conversion requirement to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip
Legal status	Financial institution incorporated as a limited company under the enterprise law
Location and outreach	National
Establishment requirements	5 shareholders, 1 major shareholder Five-year business plan
Voting rights	One share, one vote; resolutions by simple majority of shares

Resource mobilization	Member deposits, loans or grants from Lao and foreign entities
Prudential regulation:	• Minimum registered capital 1bn Kip, divided into shares • Voluntary deposits not exceeding 10 times the capital • Single-borrower limit 10% of capital • Microloans at least 80% of loan portfolio • Provisioning for loans overdue >30, >90, <180 days; 5% on performing loans • Maximum NPL ratio: 5% of loans outstanding • Write-offs: loans overdue >180 days • CAR 12% (risk-weighted) • Liquidity ratios: cash in hand 4%; overall 20% • Investments up to 10% of reg'd capital, restricted to MFIs
Auditing and supervision	Internal and external auditing, supervision by BOL Monthly, quarterly and annual reporting
Penalties for non-compliance	100,000 Kip per day to SR-MFIs incl. managers or employees Suspension and cancellation of license
Interest rate restrictions	None

Deposit-taking MFI (DTMFI) regulation: overview

Regulation No. 04/BOL	**20/06/2008 (EN)**
Conversion requirement to a regulated MFI (DTMFI or SCU)	Voluntary deposits >200m Kip, or annual revenues >1 billion Kip (NDTMFI regulation Art. 20)
1. Purposes of regulation	Safeguarding the financial system, protecting depositors
2. Terms: Microloans Major shareholder Capital: Compulsory deposit:	Up to 10m Kip Holding at least 20% of capital Initial capital, regulatory reserves, grants and retained earnings Condition for receiving a loan, a percentage or nominal amount
3. Legal status	Financial institution incorporated as a limited company under the enterprise law
4. Location	Allowed to open a head office, branches or service units in the entire country. Subject to prior approval by BOL
5/6. Establishment requirements	Minimum of 5 shareholders: individuals, partnerships, sole proprietorships, companies under Lao PDR law One major shareholder with experience in banking and microfinance Minimum registered capital: 1 billion Kip Five-year business plan demonstrating sustainablity BOL checks educational background and experience in finance, banking, accounting, auditing and management of board of directors, managaging directors. major shareholder
13. Licensing terms	Payment of registered capital in full Application fee: 1m Kip Issuance fee if registered capital is: 1-3bn: 10m Kip >3bn 15m Kip
14. Annual supervision fee	0.05% of average assets, minimum of 0.5% of registered capital
16. Minimum registered capital	1 billion Kip, divided into shares with equal value

19. Depositor protection	Member of the Depositors' Protection Fund (fee based on total deposits)
21. Organisation	General assembly of shareholders as the highest body, board of directors incl. the chairman (5-10), audit committee (at least 3), managing director (34. May not also be the board chairman)
23. Resolutions of gen. assembly	One share, one vote; resolutions by simple majority of shares
29. Meetings of board of directors	Monthly meetings, quorum of two-thirds of total members
35. Financial activities	Microloans in Kip, other loans not exceeding 20% of total loans, hard currency loans with BOL approval, voluntary and comp. deposits in Kip, hard currency deposits with BOL approval, payment and transfer services within the country, insurance as an agent, selling shares or bonds to the general public Determining deposit and loan interest rates in line with the market mechanism and regulation by BOL Loans and grants (not equity!) from Lao PDR and, with approval of BOL, from foreign organizations Depositing funds with BOL or domestic commercial banks
36. Restrictions	Leasing; dealing in precious metals or commodities, real estate and derivatives; payment services through checking accounts; foreign exchange
38. Fund mobilization restrictions	Voluntary deposits not exceeding ten times the capital Total borrowings not exceeding 30% of loans outstanding
39/41. Credit restrictions	Single borrower limit 10% of capital Microloans at least 80% of loan portfolio BOD, managing director, deputy managers, credit officers
43. Loan classification and provisioning	Performing loans: 5% Overdue 30-90 days: 25% Overdue 31-180 days: 50% Overdue >180 days: 100% NPL limit 5% of loans outstanding
46 Write-offs	Loans overdue >180 days
47. CAR (risk-weighted)	12%
48. Liquidity ratios	Cash in hand 4%; overall 20%
50. Investments	Not exceeding 10% of registered capital, restricted to MFIs
53. Regulatory reserve	5% of net profit up to 20% of registered capital
55. Taxation	Taxable according to the prevailing tax law
56. Auditing	Internal audits by audit committee External audits by external auditors and examination by BOL
57. Accounting and reporting	Accounting system and chart of accounts by BOL Monthly reporting: Balance sheet Income statement Loan and deposit report Loan classification report Annual reporting: 6 additional reports
71. Penalties for non-compliance	100,000 Kip per day to DTMFIs incl. managers or employees Temporary suspension and cancellation of licence

75. Implementation	Any state, provincial, district, village level or group organization, individual, international or private organization or enterprise currently carrying out microfinance or similar activities or planning to do so is required, within a period of 12 months from the effective date of this regulation, to comply with the requirements as stipulated in this regulation Penalties for non-compliance:100,000 Kip per day
76. Effectiveness	Replacing Regulation Number 10/BOL dated 22/06/05, effective as from the date of its signature

Source: www.bol.gov.la/english/microfinanceeng.html; www.bol.gov.la/english/mf_reg04eng.pdf

Annex 4: Village bank of Phaksapkau: Basic data and annual financial report, May 2008–April 2009 (amounts in million Kip)*

Basic data:	
Date established	May 2000
Number of members/savers	315
Percent women	69%
Number of outstanding loans	152
Percent women	100%
Management committee members	6
Percent women	100%
Advisory committee members	100%
Percent women	17%
Balance sheet:	
Savings	464.69
Interest income	132.57
Reserve fund	8.00
Development fund	5.10
Membership fees from new members	0.08
Education fund	1.70
Fines	1.37
Total capital	**613.50**
Cash at hand	121.02
Loans to members outstanding	491.85
Investments in center shares	0.10
Expenditure	0.52
Expenditure for small books	0.01
Total assets	**613.50**
Income and expenditure statement:	
Interest income	147.24
Fines (for late payment)	1.62
Membership fees from new members	0.09
Total income	148.95
Expenditure	0.52

Annex 4: Village bank of Phaksapkau: Basic data and annual financial report, May 2008–April 2009 (amounts in million Kip)*

Net profit	148.43
Without rounding:	148.42
Member savings	464.69
Profit allocation:	
Member dividends	103.89
Management committee	22.26
Advisory committee	7.42
Reserve fund	5.94
Development fund	5.94
Network services	2.97
Total	**148.42**
Profit in % of savings:	31.94
Dividends to members in % of savings:	22.36

* The items in the financial report are given in the order in which they appear in the books, except for the last two items on profits and dividends in % of savings, which have been added. The village bank was established in May; according to VB rules, the annual report therefore covers the financial year May to April.

Imprint

Published by
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internationale Kooperation
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