Making Access Possible

Lao PDR

Diagnostic
2015

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Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based country diagnostic and stakeholder dialogue, leading to the development of national financial inclusion roadmaps that identify key drivers of financial inclusion and recommended action. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. The global project seeks to engage with various other international platforms and entities impacting on financial inclusion, using the evidence gathered at the country level.

At country level, the core MAP partners collaborate with Government, other key stakeholders and donors to ensure an inclusive, holistic process. MAP Laos represents a partnership between the Bank of Lao PDR, United Nations Capital Development Fund (UNCDF), jointly undertaking the Making Access to Finance Inclusive for Poor People (MAFIPP) programme with Australian Government funding, and FinMark Trust for the development of a Strategic Framework for Financial Inclusion in Laos.

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Australian Aid

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ABBREVIATIONS & ACRONYMS

ADB	Asian Development Bank
CNY	Chinese Renminbi
FDI	Foreign Direct Investment
FISD	Financial Institutions Supervision Department
GDP	Gross Domestic Product
GDP (PPP)	Gross Domestic Product (Purchasing Power Parity)
IFAD	International Fund for Agricultural Development
LAK	Lao Kip
LFNC	Lao Front for National Construction
LWU	Lao Womens' Union
LYU	Lao Youth Union
LPRP	Lao People's Revolutionary Party
MF	Microfinance
MFI	Microfinance Institutions
NGPES	National Growth and Poverty Eradication Strategy
NPL	Non-Performing Loans
NSEDP	National Socio-Economic Development Plan
RMFC	Rural and Micro Finance Committee
SDC	Swiss Agency for Development and Cooperation
THB	Thai Baht
USD	United States Dollar
VB	Village Bank
VDF	Village Development Fund
VF	Village Fund

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1 COUNTRY CONTEXT

1.1 Geographical Context & Infrastructure

Laos has a challenging topography, but it is rich in natural resources. Bordering with Thailand to the West, with China and Myanmar to the North, Vietnam to the East and Cambodia to the South, Laos' surface area is divided into the lowlands areas along the Mekong River in Central and Southern Laos, and the mountainous region in the North and its Eastern border to Vietnam. Its topography and climate have made large parts of the country intrinsically remote. Mountains, wetlands and the effect of the climate make infrastructure very costly, especially when seen in relation to its sparse population.

Laos has a tropical monsoon climate, with a pronounced rainy season from May through October, a cool dry season from November through January, and a hot dry season in February through April. Precipitation, averaging at 1.500 mm p.a., varies significantly from one year to another and across even small distances. Droughts or floods are common events, threatening agricultural production and regularly causing devastation and disruption of road access and connectivity.

Laos is rich in natural resources that, due to its low population density and difficulty to access in the past, are still abundant. Large land areas are either covered by natural forests or used very extensively. However, with a large share of sloping land in mountainous areas, and swamp areas in the lowlands, only 4% of the land surface is classified as arable.

Table 1 - Geography & infrastructure *(Source: World Bank)*

	Unit	Lao PDR	Cambodia	Myanmar	Thailand	Vietnam	Year
Surface area	km²	236,800	181,040	676,590	513,120	330,951	2014
Road access	% of adult population	95					
Electricity	% of adult population	92					
Electricity consumption	kWh per capita	339	104	85	1,961	1,104	n/a
Mobile phone subscriptions	Per 100 inhabitants	68	134	13	140	131	2013
Internet	% of adult population	12.5	6	1.2	28.9	43.9	2013

Infrastructure is developing fast from a very low level. Road construction has been very intense for a decade, and a network of all-weather and paved roads is soon to be completed, aiming to connect all districts, as well as dirt roads for dry-season access to villages. The present road network stretches over 15,597 km, of which 18% are paved roads[1]. With the support of its neighbouring countries, a domestic network of national border-to-border highways has transformed Laos from a 'landlocked' into a 'landlinked' country.

With the exception of a 2.5 km extension of the Bangkok - Nongkhai link into Laos close to its capital, there is no railroad network. The National Assembly has previously approved an ambitious proposal to connect China and Thailand via a high-speed rail through Laos with implementation initiated.

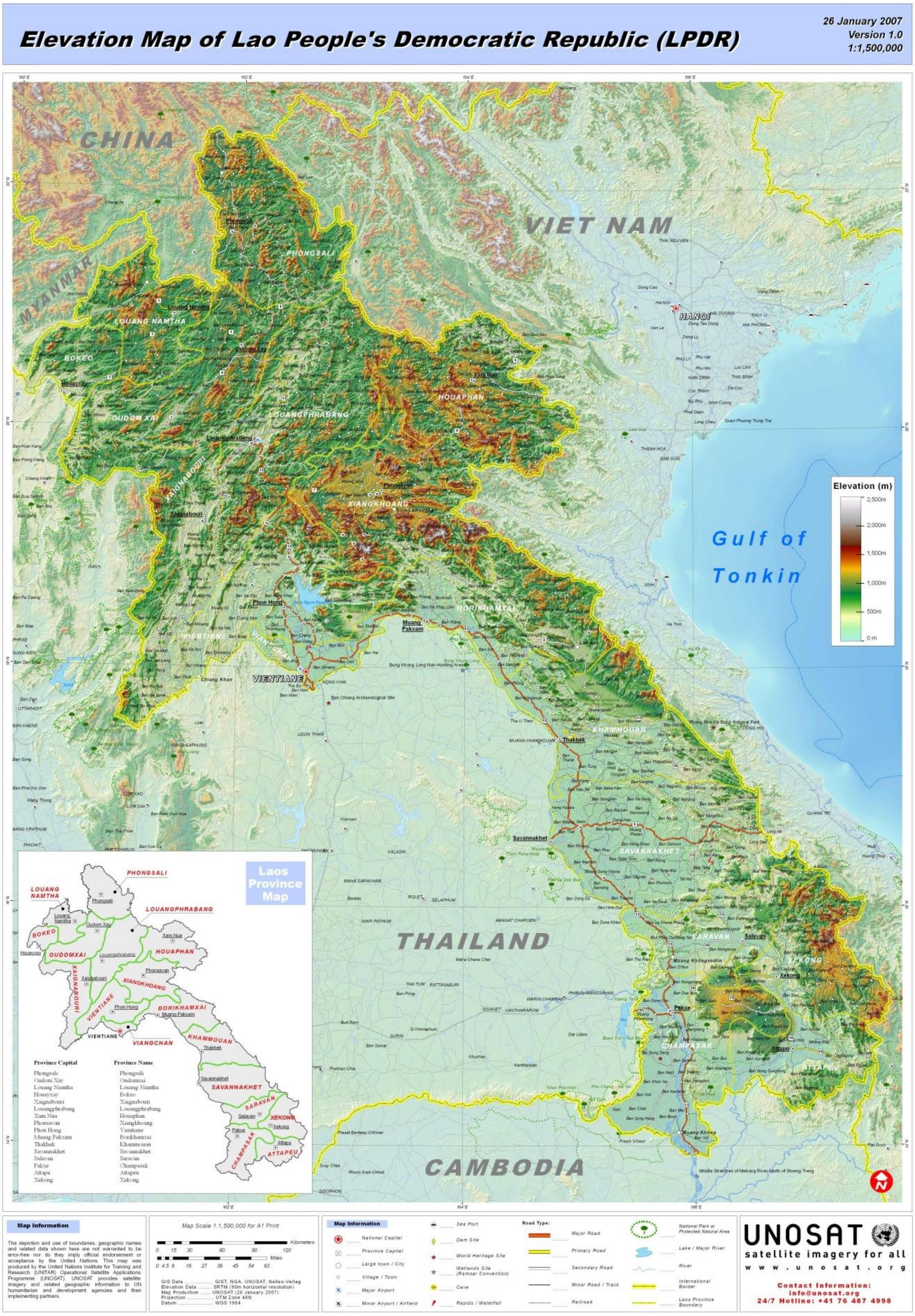


Figure 1 - Map of Laos

Electrification is progressing fast. Given its surplus production of hydropower electricity it is an obvious development goal for the Lao government to connect all villages to the national power grid: presently 69% of villages are connected. In the remaining 31%, many households have access to low-voltage power from fuel, water flow-driven generators or solar power. 92% of FinScope respondents report household access to electricity, though only 75% in rural areas without road connection. Therefore, the use of electric household appliances is high: 85% of households own a TV, and 70% a refrigerator.

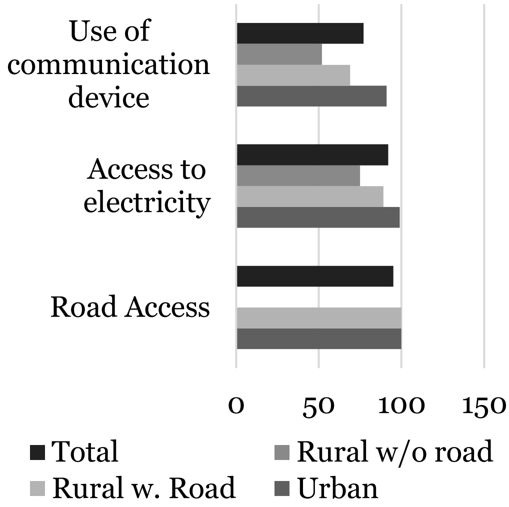


Figure 2 - Access to communication device, electricity and road

Use and coverage of telecommunication networks remains low in remote rural areas. Similar to other countries with a low density of landline connections, the mobile telecommunication network has been growing rapidly, although coverage is not yet complete. There are large gaps in mountainous areas and areas with low population density. The use of cell phones is common (77%), with large differences between locations: while 91% of adults living in urban areas use cell phones, the rate drops to 52% in rural areas with no road access.

1.2 Historical & Political Context

Since 1975, Laos has been a single-party socialist republic. The Lao government system is a Leninist-type single-party socialist republic. It came into power in 1975, replacing a US-supported feudal system after more than a decade of devastating civil war.

Adoption of market economy in 1986 and subsequent process of regional and international integration. After a period of initial isolation and cooperation restricted to other communist nations, the country has adopted market economy since the late 1980s and opened up for international political and trade relations. At the same time, the government has systematically consolidated and extended state control. The government has been successful in fostering continuous economic growth, political stability, peace and low levels of criminality. The low level of political freedom, frequent cases of abuse of power by political leaders and the effective suppression of any attempts of political opposition[2] are tolerated by the population. A recent Gallup poll[3] revealed a very high government approval rate.

Everybody owns civic identification documents. One of the components of the government's efforts to gain political and administrative control is compulsory identification required for all persons residing in Laos: by law every citizen has to be included into the 'family census book' shortly after birth. An ID card is required[4] to travel outside of one's home district.

The role of the Revolutionary Party.

The Lao People's Revolutionary Party (LPRP) has the highest ideological and strategic power within the political system. Between its five-yearly party congresses - the most recent being the 9th Party Congress in 2011 - the powerful 9 members of the Politburo and the 49-

members of the Central Committee are responsible for determining the overall direction and main political decisions.

State structure in LAO PDR

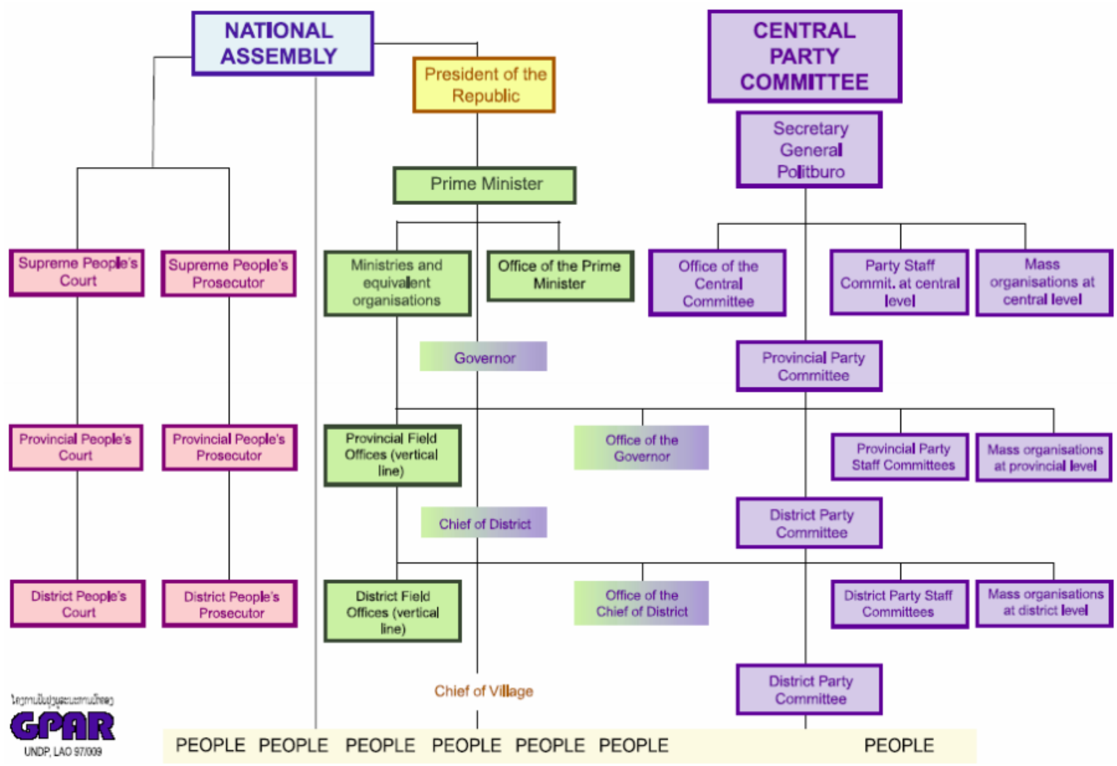


Figure 3 - State structure in Lao PDR *(Source: United Nations, 2005)*

Government structure. The President (Mr. Choummaly Sayasone, since 2006), who is also the LPRP General Secretary, is elected by the National Assembly for a five-year term. The Prime Minister (Mr. Thongsing Thammavong, since 2010) and the 28-member Council of Ministers are appointed by the president for a five-year term upon approval of the National Assembly.

Legislation. The National Assembly is the country's parliament and legislative branch. Its 132 members are elected by the electorate for five-year terms. At the last elections in 2011, members of the PRPLPRP won 128 seats, the remaining seats going to non-partisan candidates pre-approved by the party.

Mass organisations. Similar to other communist countries, Laos has four mass organisations closely affiliated to the government. The Lao Women's Union (LWU), the Lao Youth Union (LYU), the Lao Front for National Construction (LFNC) and the Lao Federation of Trade Unions (LFTU) have a strong propaganda and development mandate despite not being directly incorporated in the governmental structure. The former three of them have considerable presence and influence at the community level.

Administrative structure. The administrative structure is divided into the central level, based in the capital of Vientiane, and the decentralised level structured under 18 provinces including Vientiane Prefecture, 145 districts and 8,622 administrative villages comprising an estimated total of more than 10,000 hamlets.

Process of integration of rural areas into the administrative structure. Rural areas have been subject to strong attempts of the government to foster socio-economic development in villages, as well as to increase its control over them. The district and village levels, once rather autonomous, are now strongly integrated into the state government.

Decentralisation policy: The Sam Sang policy. A process of decentralisation has been started in 2000, defining the province as the strategic entity for planning-related programmes and the district as the budget execution entity[5]. In 2012 the Sam Sang ('Three Builds') directive was issued. It aims to build provinces as strategy-making units, districts as comprehensively strengthened units, and villages as development units.

Democratic tradition. At the community level, Laos has a strong democratic tradition. Agreements are closed by community leaders following a negotiation process between divergent interests. This culture is prevailing up to today. However, these processes are often overruled by the Party or for personal political interests.

Political decisions. Political decision-making processes are highly inclusive within the government, but information is rarely and hesitantly shared with the public. For high-level issues, committees consisting of members of relevant agencies are formed to ensure representation of all parts of the government. The sequence of drafting, consultation and re-drafting, until common positions are reached, can be lengthy. Thus decision-making processes within the party and the government are often perceived as slow, hierarchical and non-transparent for outsiders.

Corruption is common, ranging from small 'gratitude fees' given to low-ranking government officials for easing or speeding up every day administrative processes to diversion of public funds and large-scale corruption by high-ranking persons[6]. Laos scores only 25 out of 100 (100 for 'very clean') on Transparency International's 2014 Corruption Perception Index listing[7], ranking it 145 out of 175 countries.

Judicial system. The legal system in Lao PDR is based on the National Assembly's role as the highest legislative body, granting power to ministries to issue decrees, regulations and guidelines. The system of people's courts in Laos is comprised of the People's Supreme Court, People's Provincial and Municipal Courts, People's District Courts, and Military Courts.

With less than 100 educated lawyers in the whole country, the required expertise on laws, legal concepts and judicial processes is very limited and legal drafting skills remain weak despite international organisations' support[8]. Legal cases tend to be lengthy, and their outcome can be influenced by non-juridical factors, such as party politics, power relations and bribes.

The use of the formal legal system is seldom for civil cases; most cases of conflict are solved through local arbitration and by customary law. On the other hand, Laos' informal sphere is slowly shifting to a more formal one. Indeed, several of the financial institutions interviewed have successfully pursued loan default cases in court. In 2013, loan-related disputes have become the second most common cases in district courts[9].

Balance between economic growth and social development is a government priority. The current National Socio-Economic Development Plan 2011 – 2015 establishes four main targets:

- Maintain high economic growth at a level of 8% *p.a.* over the period.
- Increase efforts to achieve the Millennium Development Goals (MDG) and to transition from the

country's current Least Developed Country (LDC) status by 2020.

- Ensure the social and environmental sustainability of economic development.
- Maintain political and cultural continuity while opening to regional and international integration.

The Lao government policy has a strong focus on poverty reduction. Due to its history and ideology, the Lao government emphasises its strong commitment to fight poverty. A focussed and systematic approach was taken with the development of the National Growth and Poverty Eradication Strategy (NGPES) in 2003, which until today remains a main reference for policy decisions on poverty alleviation.

Rural development and poverty alleviation priorities are incorporated into the five-year National Socio-Economic Development Plans (NSEDP) that shape government intervention and policy according to the ideological and strategic decisions made by the preceding Party Congresses. The present 7th NSEDP runs until 2015. The 8th NSDEP for the period 2016-2020 is presently being drafted.

1.3 Demography, Human Resource Development & Labour Force

Table 2 - Data related to demography, HRD & labour force

	Unit	Lao PDR	Cambodia	Myanmar	Thailand	Vietnam
Population number *2013*	No.	6,769,727	15,135,169	53,259,018	67,010,502	89,708,900
Population Density *2014*	Inhabitants per km2	29	85	82	132	282
Median age 2014 est.	y	22	24.1	27.9	36.2	29.2
Population growth *2014 est.*	% p.a.	1.59	1.63	1.03	0.35	1.0
Urbanisation *2013*	% of population living in urban areas	36	20	33	48	32
Urban population growth *2013*	Growth of urban population/ growth of total population in %	4.9	2.7	2.5	3.0	3.1
Net Migration Rate *2014 est.*	Migrants/1.000 inhabitants	-1.1	-0.32	-0.3	0	-0.32
Life expectancy at birth *2013*	year	68.2	71.7	65.1	74.4	75.8
Literacy rate *2013*	% of 15 y and older	72.7	73.9	92.7	93.5	93.4

	Unit	Lao PDR	Cambodia	Myanmar	Thailand	Vietnam
Education index *2013*	Calculated using Mean Years of Schooling and Expected Years of Schooling	0.436	0.553	0.371	0.608	0.513
Human development Index *2013*	composite index*	0.569	0.584	0.524	0.722	0.638

** Composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living*

Small, but fast growing population. With 6.8 mio. persons recorded, Laos has the smallest population amongst its Southeast Asian neighbours. The population density is the lowest with 29 inhabitants per km². The mountainous regions to the North and East are the least populated. The main part of its population lives on the fertile lowlands along the Mekong River in Central and Southern Laos, where the largest cities are also located.

The population growth rate is the highest in the region, due to high birth rates in rural areas and the absence of birth regulation policies enforced in China or Vietnam. With such a young population, the dependency rate is high, currently reaching 40%. However, the birth rate has decreased substantially in the last decade, leaving the country with a future 'workforce bonus' for the next decades, as a large share of the population will be of working age, and the share of dependents will decrease temporarily.

National statistics based on nationality, not on residence. Lao census statistics do not follow international practices concerning foreign nationals residing in Laos. Officially only 19,000 foreigners have been included into the last census in 2005, however, the estimated number of foreign nationals residing in Laos is far higher. The majority come from China and Vietnam. Some are employed only on a temporary basis, while others have strong or even permanent affiliation as business owners or permanent employees. A significant part of these migrants is working in Laos without a work permit[10].

On the other hand, Lao nationals living and working abroad are included in the census, as long as they maintain their local registration, even though they may actually not reside in Laos. The main destination for Lao nationals is Thailand with an estimated 300,000 persons working there [11].

Laos has a large ethnic diversity and a culture of peaceful coexistence. Because of historic migration patterns and the low degree of state authority and cultural integration in the past, up to this day Laos has one of the highest levels of ethnic and cultural diversity in the world. With only 6.8 mio. inhabitants, the government distinguishes between 160 ethnic groups within 49 main ethnicities[12]. The Lao Front for National Construction (LFNC), that is responsible for issues regarding culture, religion and ethnic minorities, uses the classification of ethnic groups according to their ethno-linguistic characteristics.

Over two thirds of the national population belong to the 8 ethnic groups within the Lao-Phoutai language family. The remaining 33% of the population belong to ethnic minorities traditionally affiliated with the uplands of Laos.

Table 3 - Categorisation of ethnic groups in Laos *(Source: World Bank, 2014)*

Ethno-Linguistic	Topographical	Language Family	No of ethnic groups	Proportion of population
Tai Kadai	Lao Loum (lowland)	Lao Phoutai	8	66.7%
Austroasiatic	Lao Theung ('sloping land')	Mon Khmer	32	22.1%
Hmong - Lu Mien	Lao Soung ('hilltops')	Hmong - Lu Mien	2	3.4%
Chine - Tibetan	Lao Soung ('hilltops')	Tibeto Burman	7	7.1%
			Others	0.7%

High cultural diversity with a predominant ethnic Lao culture. Each of these ethnic groups features its distinct set of cultural values and identity. Despite these differences, virtually no ethnic-related conflicts have been reported, ethnic groups living together peacefully and united by a strong national identity.

The large majority of Laotians belong to the Tai-Kadai, which has a traditionally feudal, Buddhist, and paddy-farming culture. A patchwork of minority groups occupies the vast mountainous areas in the North and towards the Vietnamese border. Their traditional main occupations, now gradually replaced by crops and livestock for emerging markets, are slash-and-burn cultivation of the sloping lands to produce their main staple food, rice, and gathering of food and other products in the vast surrounding primary and secondary forests. Minority groups are included in the governing structure developed within the lowland culture, however they remain marginalised in terms of political representation, education level and level of economic development. Most ethnic minority groups are heavily overrepresented in Laos' poverty statistics (see Socioeconomic Context).

An agrarian economy with a rapid urbanisation. With the majority of people (64%) living in rural areas, Laos is still an 'Agrarian Economy'. However, the strong growth in the industrial and service sectors is driving a surge of rural dwellers towards the urban growth centres, notably the cities of Vientiane, Pakse and Savannakhet. Urbanisation in Laos is progressing faster than in the surrounding countries, driven by push and pull factors including growing job opportunities in urban centres, poverty in rural areas and the traditional willingness to migrate for better conditions.

Labour force. The labour work force is estimated to be 3,445 mio. (2014 est.), with an official unemployment rate of 1.3%[13]. This very low rate must however be considered in light of the absence of a national employment agency to facilitate employment and benefit system to unemployed persons and thus the lack of tools to collect data on unemployment. Nonetheless, a very large percentage of firms in Laos complain that there are no or too few applicants to offered jobs, which is far higher than in Vietnam and China[14]. Rather than unemployment, underemployment or low productivity represent key issues. In particular the agricultural sector's distinct seasonal work during the rice growth season and its extensive production systems presents low outputs per labour.

The level of formal employment remains low. According to FinScope 15.2% of adults are formally employed, which is by far dominated by the public sector that accounts for 10.7% of formal employment. Private companies accounted for the remaining 4.5%, mainly in the form of low-skilled labour.

A poor education system. According to the Lao government, the low education and skills level is the biggest challenge to achieve sustainable development in the long term[15]. After its devastating civil war that ended in the overthrow of the former elite, Laos experienced a major exodus of its academic elite, which it is still struggling to overcome. However, efforts to improve its education system seem ineffective, and are furthermore obstructed by the obstacles of a 'small language', and a culture where academic excellence has little social value. With a similar historical background, Vietnam has achieved far higher levels of basic skills amongst its population. A basic literacy assessment[16] carried out in both countries revealed that Lao secondary and tertiary education graduates had about the same literacy level as Vietnamese primary school graduates. Over 50% of primary, and over 15% of secondary and post-secondary graduates in Laos were found functionally illiterate.

The Laotian government aims at providing universal education to all its citizens. There are no school fees for primary and secondary education in public schools, and tertiary education entails low school fees. In practice however, bribing teachers and references to influential persons are found to be common practice to increase grades and chances of admission.

Chances of admission and graduation at a higher education institution are correlated with wealth and connections rather than on academic performance[17*]. The education sector is seeing a fast-growing network of private schools and universities, offering higher quality education at a higher cost. Corruption in the private education sector is also widespread, but to a lower extent compared to the public sector.

A poor healthcare system. Laos has one of the poorest performing healthcare systems in the world, resulting in widespread health tourism to Thailand and China. This phenomenon also concerns people living in remote areas able to raise money to send their family members to Thailand when traditional healers and local private and public clinics have failed.

1.4 Macroeconomic Context

Table 4 - Data on macroeconomic context

	2009	2010	2011	2012	2013	2014	Cambodia 2013	Myanmar 2013	Thailand 2013	Vietnam 2013
GNI per capita, PPP *(current international $)*	3.450	3.570	3.840	4.170	4.550	4.910	2.890	n/a	13.430	5.070
GNI per capita, PPP growth rate *(% p.a.)*	8.5	3.47	7.56	8.59	9.11	7.91	6.64	n/a	0	5.63
Inflation, GDP deflator *(% p.a.)*	-2.93	10.01	3.80	4.31	8.14	4.13	0.81		2.79	4.76

	2009	2010	2011	2012	2013	2014	Cambodia 2013	Myanmar 2013	Thailand 2013	Vietnam 2013
External debt Ratio *(% of GDP)*				80	84		33	25		

Strong and stable growth, highly dependent on the performance of the large economies in the region. The Lao economy presents typical features of a country in transition. Political and monetary stability have contributed to high and sustained economic growth. For a number of years, growth has been largely attributed to the exploitation of natural resources, minerals, wood and hydropower; recently the agriculture and services sectors have increased their contribution to economic growth[18].

Laos was relatively unaffected by the 2008 financial crisis due to the low level of development of the financial sector at that time. In its aftermath it has even profited from the subsequent re-orientation in particular of Chinese investors towards emerging markets in the region. Strong economic development in the region has increased the amount of Foreign Direct Investment (FDI) directed into the country, which strongly contributes to the current development.

The national currency is stabilising, after experiencing hyperinflation in 1999. In 1999, unmanaged public budget overspending resulted in exponential inflation and a collapse of the currency. The government has since supported the central bank in its efforts to stabilise the national currency. Over the last decade, the inflation rate has been steadily decreasing. In the fourth quarter of 2014, year-over-year inflation was as low as 2.75%.

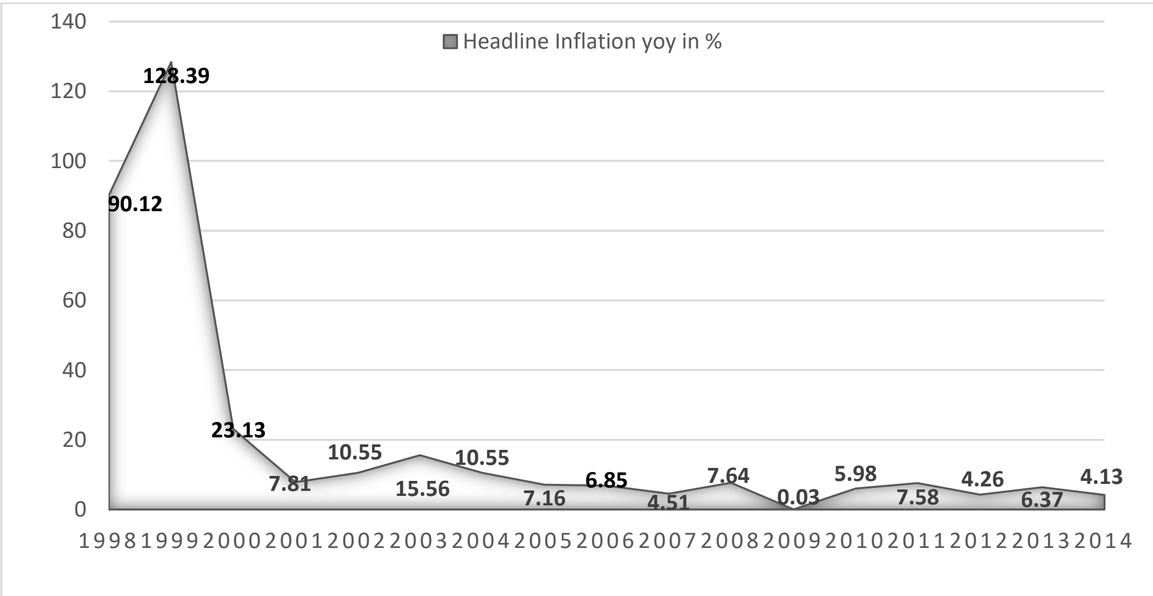


Figure 4- Headline inflation in Lao PDR 1998 – 2014 *(Source: Dalaloy, 2015)*

The Lao economy has a high level of dollarization. Even before 1999 the use of foreign currencies was widespread. Hyperinflation affected the trust in the currency, and for many years, Laos was in fact a three-currency economy. The Lao Kip (LAK) was used for daily small expenses. The Thai Baht (THB) was used for medium and larger expenses and as the predominant currency in areas close to the Thai border. In many cases, the US Dollar (USD) was used for high value items like cars and property. Villages bordering China and engaging in trade commonly use the Chinese Yuan Renminbi (CNY). A broad number of high-level policy measures and intensive campaigning by the Bank of Lao led to a substantial reduction of the previously high level of dollarisation[19].

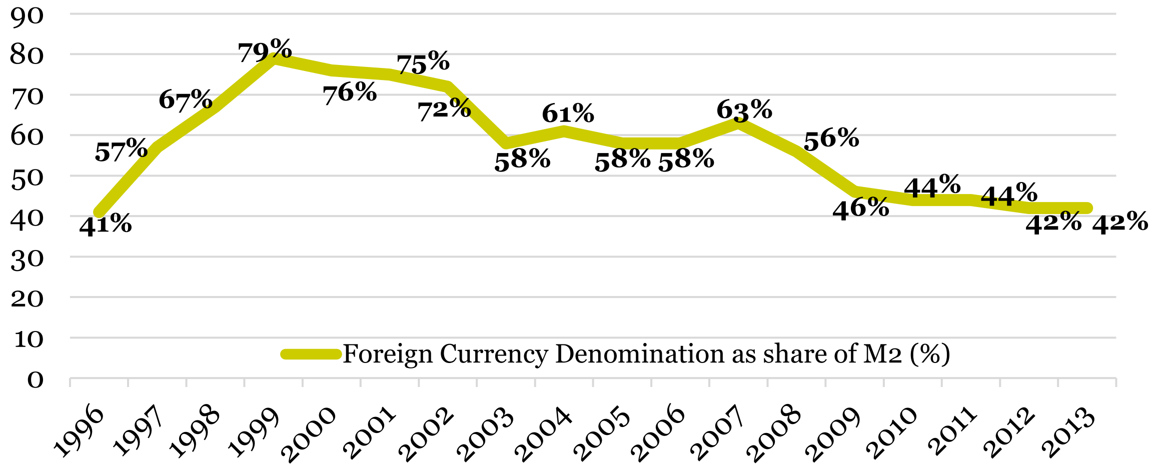


Figure 5 - Foreign currency denomination/M2 1996 –– 2013 *(Source: Dalaloy, 2015)*

Borrowing in USD or THB remains common due to lower interest rates; however borrowers may be unaware of the exchange risks inherent to these loans.

Due to strict management by the central bank, the Lao Kip is stable, with a tendency to be over-valued. The foreign exchange rate of the Lao Kip has been stable over the medium term, and has seen an appreciation of 30% over its reference currencies within the last 5 years.

The exchange rate is not market-determined; it is fixed by the Bank of Lao within a 0.5% band, supported by exchange controls, including a LAK 20 mio. ceiling for daily exchanges made by private customers.

High fiscal deficits in previous years. Previous years have seen a widening of the fiscal deficit caused by large public investment programs, a large increase in civil servants' benefits and a weakening of the state revenue due to falling gold prices, which contributed to a peak in the Fiscal Year 12/13 at -6.0% of GDP. This deficit has been reduced due to subsequent cuts in public spending, and is aimed at not exceeding 5% of GDP[20]. In order to operate within budget constraints, the government often postpones payments of salaries and due invoices, with large implications for financial institutions' loan portfolio.

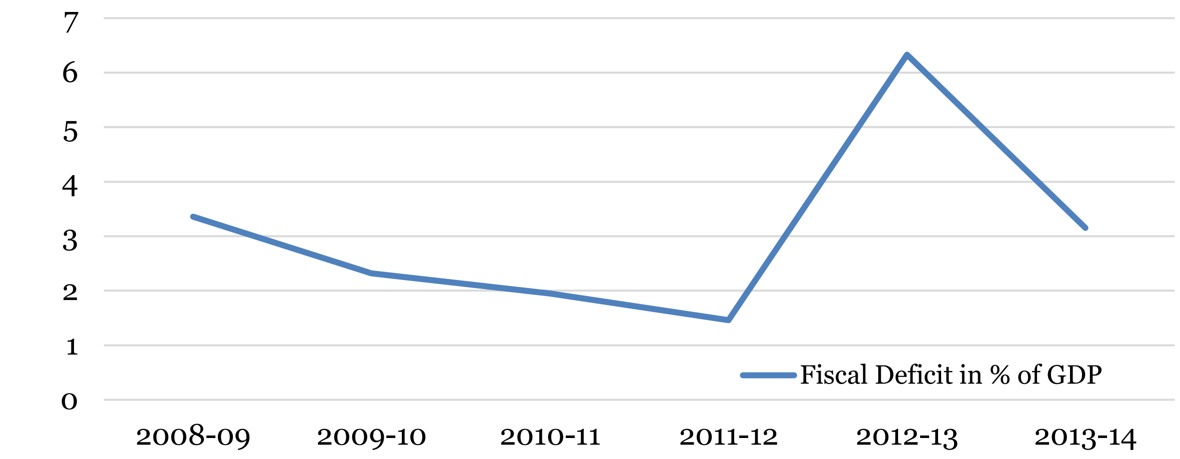


Figure 6 - Fiscal deficit in % of GDP *(Source: BoL, 2015)*

The level of public debt is medium, with only moderate risk of debt distress. Total public sector (domestic and external) debt is estimated at 59% of GDP at the end of 2013[21]. Of this, domestic public debt stood at about 11% of GDP - consisting of commercial bank lending and bond holdings as well as the Bank of Lao's direct lending to the government's off-budget infrastructure projects.

Foreign public debt amounts to 48% of GDP, which is relatively low from an international perspective, but it is one of the highest in the region. The World Bank assesses the risk for debt distress as being moderate, as a large part of public debt is on concessional terms. Most of the external public debt is denominated in foreign currencies, making it vulnerable to a risk of significant exchange rate depreciation.

Deepening of the financial system and high credit growth recently slowing down. The government has promoted a deepening of the financial sector, which has seen very high growth rates of M2 and credit during the last decade.

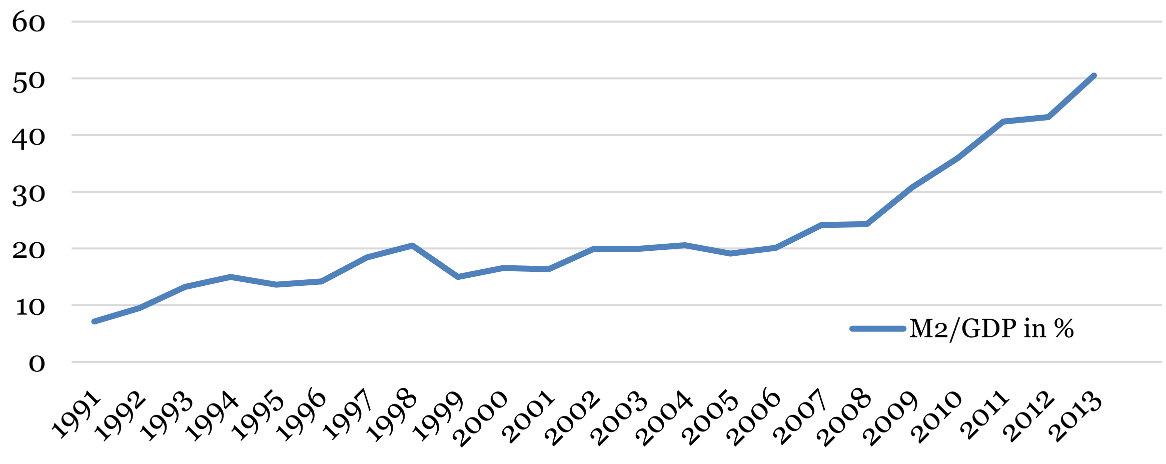


Figure 7 - M2/GDP 1990 - 2013 *(Source: Internet Source 5, BoL Annual Economic Reports 2011 – 14)*

In particular 2008-09 and 2012 have seen very high growth rates in credit, over 100% *p.a.* in 2009, and over 60% in 2012. By the end of 2014, however, annual credit growth slowed down to 14%. The high growth rate of bank lending during recent years has led to increasing delinquency problems, and banks are currently struggling to consolidate their loan portfolio[22].

The share of bank lending to state-owned enterprises[23] has steadily decreased. However, as many privately-owned enterprises especially in the construction sector have been depending on public investment projects, delayed payments from the government have recently resulted in a sharp increase of delinquent loans in this segment.

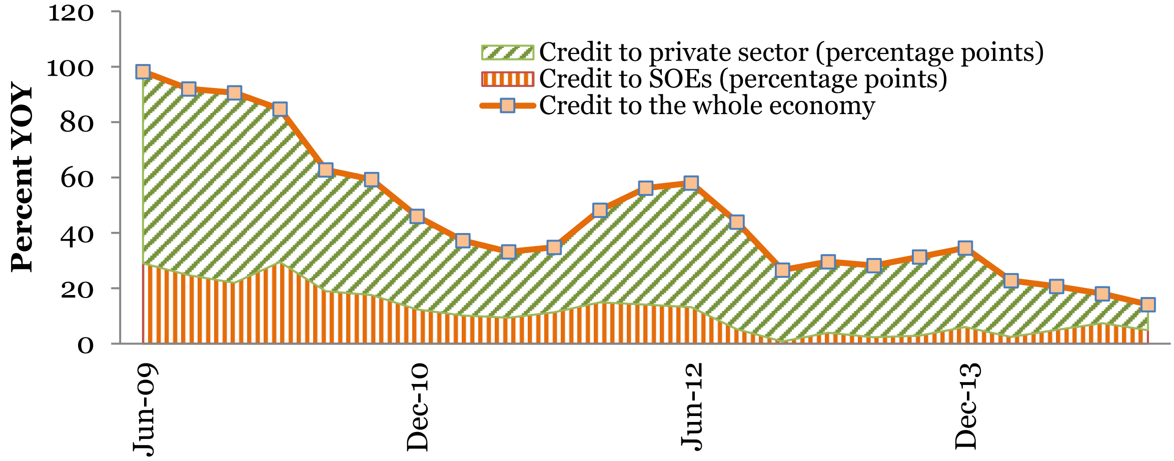


Figure 8 - Domestic credit growth 2009 – 2014 *(Source: World Bank, 2015b)*

Main Sectors with in depth description of agriculture, incl. The following on land ownership.

According to Article 17 of the Constitution, ownership of all land lies with the State; however permanent user rights can be vested to individuals, families, enterprises and governmental organisations. Similarly to all neighbouring countries, no ownership of land is vested to non-citizens, apatride and foreign organisations. In turn, they can lease or receive concessions of land from the State or Lao citizens.

The period of land lease or concession can occur for a maximum of fifty years and is regulated by the 2003 'Land Law'. Before the onset of governmental integration of rural areas, land was administered by the village communities. High value land such as paddy fields and gardens traditionally belong to family possessions, while forest, grassland and sloping areas for slash-and-burn cultivation are common land under community management. Rural development projects have initiated land use planning processes mapping villages' land by use and allocating individual land plots to all resident families.

There are two types of land documents – land certificates, and official documents certifying the temporary use right of agriculture or forest land, which are issued by the district or municipal administration. Individuals or organisations holding a land certificate benefit from an inheritance right, but do not have the right to transfer or use the land certificate as share contribution, collateral or for lease purposes. Another type of land document are land titles, the sole document considered as evidence for permanent land use rights. Land titles are issued by Provincial and Central Land Management Authorities. This process has been mainstreamed and is presently enforced nation-wide.

Agriculture represents the largest employment sector, but with very low productivity. Even though 78% of Lao adults' income derives from agricultural activities[24], the sector's share of the GDP is only of 25%[25].

Subsistence agriculture focused on rice production and gathering of non-timber forest products from the vast forest-covered areas of Laos are the traditional sources of income for a majority of citizens. The vast majority of agricultural producers (91%)[26] farm their own land. The increase of agriculture-related infrastructure coupled with an increased and diversified demand for agricultural and forestry products such as rubber, coffee, cassava starch and sugar are fostering the process of commercialisation. An increasing part of agricultural production is dedicated to high-value commodities.

An industrial sector dominated by resource extraction and manufacturing. Mining for copper and gold ore, electricity production from hydropower and coal as well as manufacturing represent the main drivers for industrial production, which accounted for 29% of GDP in 2014.

A growing service sector. Trade, public services and transport are growing strongly, as well as tourism. The service sector contributed to 39% of GDP in 2014.

The SME sector dominates economic activity in Laos. It accounts for substantial employment, and for a substantial share of GDP. According to most recent data[27], 81% of self-employed persons had no employees, and 98% of all enterprises were considered as SMEs with 10 workers or less. Over half of SMEs were unregistered, primarily due to the high cost of licensing.

1.5 Regional Context, Economic Integration and Trade

Laos is strongly integrated in the regional context, yet presents a weaker integration at the global level. Since its period of initial isolation in the 70's and 80's, Laos has become a member of all relevant regional and international organisations[28]. At the global level however, WTO membership was only approved in 2013.

The Southeast Asian context. Laos' regional integration has been boosted since it acquired membership of the Association of South East Asian Nations (ASEAN) in 1997. ASEAN, founded in 1967, aims at promoting economic growth, social progress, and sociocultural development, and at preserving regional peace and stability. Although politically and economically diverse, the ten ASEAN members have achieved a relatively high level of trade liberalisation and administrative cooperation. By the end of 2015, ASEAN plans to establish a common market. The single market will ensure the free flow of goods, services, investment and skilled labour and the free flow of capital.

The ASEAN Plus Three initiative includes the region's main trade partners - China, Japan and South Korea – to further regional integration.

Laos has successfully shifted its position from a small country surrounded by larger countries and competing powers such as Thailand, Vietnam and China, to one of regional mediator, buffer and link between its neighbouring countries.

Foreign Direct Investment is significant and primarily directed at large-scale electricity generation projects. Laos attracts a large and increasing inflow of Foreign Direct Investment. Most large-scale projects in Laos are financed by foreign investors, and the segment of medium and large enterprises is dominated by foreign-owned companies. The amount of Foreign Direct Investment has exceeded half billion USD in 2014[29]. China, Vietnam and Thailand are the main investors. The large influx of foreign capital and expertise to Laos has subsequently resulted in a redistribution of its resources. Most of the medium and large enterprises across all sectors are foreign-owned. Large land areas are occupied by land concessions to foreign companies. Foreign companies tend to employ staff of their own nationality for medium-level and management positions, however a high share of unskilled labour is recruited locally. Similarly, the financial sector is increasingly dominated by foreign capital.

The largest share of Foreign Direct Investment (more than 80%) is directed towards the development of large-scale electricity generation projects; mining, service and agriculture sharing the remaining 20%[30].

Overseas Development Aid (ODA), once accounting for a considerable part of public funding, is decreasing following Laos' strong economic growth. In 2013 ODA was accounting for 4.0% of Gross National Income (GNI)[31].

Main trade and economic partners and commodities. Laos' main export products in 2012 were metals and mineral products (mainly copper and gold - 52%), textiles (12%) and wood products (11%); the main agricultural export products were coffee and rubber (6%). Total exports amounted to 2.13 bio. USD. The main import commodities are machinery (19%), vehicles (16%), metals (mainly iron, 15%) and foodstuff (10%). The total value of imports reached 3.59 bio. USD, leaving a trade deficit of 1.46 bio. USD. Regional trade is predominant, with China, Thailand and Vietnam as major trade partners. Additionally, Japan, India, South Korea and Germany significantly contribute to trade.[32]

1.6 Socioeconomic Context

Lao society builds on clan and village community. The family, often living under the same roof with other members of the extended family, is the basic economic labour- and income-sharing unit. The extended family remains the main reference for social security, professional networking and, as documented by FinScope, for basic financial transactions. Although traditional cohesion especially within rural communities has undergone dramatic changes caused by relocation, migration patterns, cultural changes and political interference, it remains a strong component of Lao society. 94% of Laotians trust in their village community, the highest rate worldwide[33].

Table 5 - Data on social indicators

	Unit	Lao PDR	Cambodia	Myanmar	Thailand	Vietnam
GINI Index (WB est.)		36.2 (2012)	31.8 (2011)	n/a	39.4 (2010)	35.6 (2012)
HDI (UNDP) (data 2013)		0.569	0.584	0.524	0.722	0.638
Gender Inequality Index /rank (UNDP) (data 2013)	High index – high inequality	0.534/ 118	0.505/ 105	0.430/ 83	0.364/ 70	0.322/ 58
Poverty headcount ratio at $1.25 a day (PPP)	% of population	30.3 (2012)	10.1 (2011)		0.3 (2010)	2.4 (2012)
Poverty headcount ratio at national poverty lines (data 2012)	% of population	23.2	17.7	n/a	12.6	17.2
Poverty headcount ratio at national	% of rural population	28.6				

	Unit	Lao PDR	Cambodia	Myanmar	Thailand	Vietnam
poverty lines rural areas						
Poverty headcount ratio at national poverty lines urban areas	% of urban population	10.0				

Ethnic diversity. The traditional differences in cultural values and economic approaches between ethnic groups are significant, thus contributing to a heterogeneous socioeconomic context. Constant changes in living conditions result in adjustments and adaptation and mainly assimilation towards the dominating culture of the ethnic lowland culture. However, despite the process of cultural assimilation, there is still considerable variation between economic behaviour and strategies of ethnic groups. Such strategies have a strong effect on the uptake of financial services, especially concerning credit-adversity and propensity to save[34].

Beyond clan level, mutual help, pooling of labour for private or communal purposes are common. However there is no tradition of joint enterprises, such as cooperatives, that promote joint financial responsibility with non-relatives.

Tradition and economic behaviour. Buddhist culture and Communist ideology that have been major determinants of the Lao culture in the past, have both been promoting 'the simple life' without dependency on material possessions.

A very strong resilience and a high ability to sustain a good quality of life even under adverse circumstances is characteristic for most Laotians. A traditional pride is found in sustaining livelihoods without having to ask for support. Many have a fatalist view towards life, and - faced with the uncertainty of future – have a short-term perspective rather than a long-term one. This has a direct impact on economic decisions of resource allocation for which a distinct short-term preference can be observed.

However, the majority of families have an active strategy to mitigate or prevent falling into poverty in the case of emergency situations.

About the influence of culture on economic behaviour.
I have done / written a lot on this topic. I would say that ethnicity composes 80% of such economic behaviour. But it's always overlooked by 95% of outsiders. But the people / farmers know themselves.
Mike Carroll, pers. message

This tradition is under rapid change due to global influences, and the high exposure of Lao culture to consumerism, which is growing in the South East Asian region, and predominantly in neighbouring Thailand.

Laos is experiencing a surging demand due to a continuous increase in consumption. In the earlier stage of self-sufficiency and isolation, the offer in terms of goods was limited as well as purchasing power. Now, the appetite for consumption often exceeds income and many households increasingly experience financial stress.

Civil society in Laos beyond the clan and village levels is almost non-existent. There is no tradition of civic institutions fostering the interest of groups of citizens. According to communist ideology, the Communist party and the political mass organisations harbour represent all interests of the people.

Consequently, the Lao government is extremely wary of independent initiatives. Non-governmental organisations (associations) have only recently been permitted in 2009[35].

The few associations (amongst them the Lao Microfinance Association) that have been licensed since then, are under strict observation and state control.

Poverty reduction in Laos is progressing well, however we observe rising inequities and the absence of pro-poor growth. Laos was considered the poorest country in South East Asia. Nowadays strong economic growth, the government's dedication to developing rural areas and the efforts of numerous poverty-oriented development projects have succeeded in substantially reducing poverty. GNI per capita has increased dramatically, and Laos now belongs to the lower middle-income group of countries. Within 20 years, from 1992 to 2012, the poverty rate has been halved, from 46% to 23% and the downward trend is currently sustained. However, despite having higher per capita average income than Cambodia and Myanmar, Laos is featuring higher levels of poverty caused by larger income disparities. Lao consumption surveys reveal that growth within the last decade has been more favourable to the non-poor.

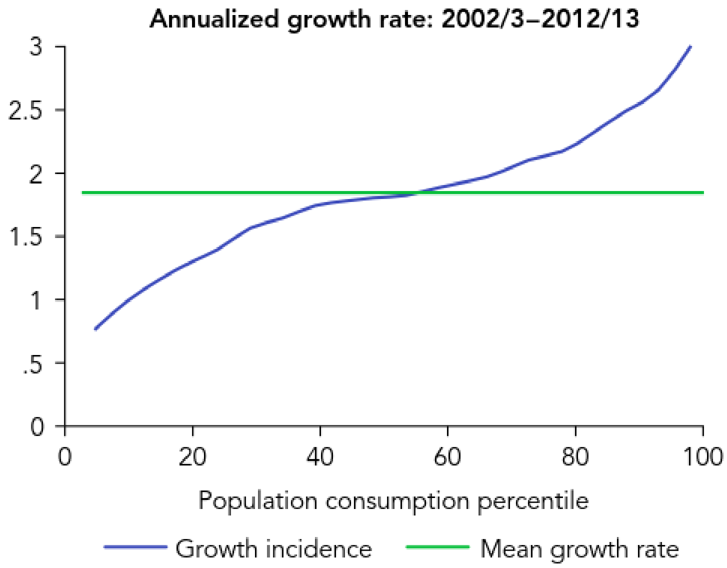


Figure 9 - Distributional growth patterns in relation to consumption percentile *(Source: Lao National Statistics Bureau, 2014)*

After the 1975 revolution, Laos presented a low level of economic inequality: many wealthy families had left the country and the Party promoted the virtues of a simple life; everybody was equally poor. After 3 decades of market economy, Laos' Gini index (36.2 in 2012) has been increasing steadily, a similar trend to other socialist or former socialist countries. The rapid development of urban centres contributes to increasing the gap between urban and rural areas. A widening gap within urban areas is also observed, due to the formation of a wealthy elite and the emergence of an urban middle class of government employees and successful business owners. However, poverty in Laos is not associated with social exclusion. The settlement pattern in urban areas is little affected by poor or better-off neighbourhoods, and the urban poor are not confined to slums or shanty towns.

Destitute poverty is rare. Poverty in Laos only rarely takes the dimensions of deprivation and hunger due to the still abundant natural resources and the strong tradition of support within social networks. Another perspective on the level of poverty in Laos is illustrated by the large amount of Chinese and Vietnamese economic migrants to Laos, meeting the demand for precarious jobs that are disregarded by Lao nationals[36].

Despite rare cases of destitute poverty, poor people's livelihood remains vulnerable. The rural population is highly vulnerable to natural disasters. In particular, climate change is contributing to increasingly erratic rainfall pattern recorded in recent years. Areas in Southern Laos that previously have been considered as better-off have experienced a substantial relapse into poverty after seasons of drought or heavy flooding[37].

Poverty in Laos is strongly correlated with rural areas and with ethnic origin. The poverty rate is almost three times higher in rural than in urban areas. As rural areas account for 71% of the Lao population, the overwhelming majority of the poor are rural residents (88%).

Table 6 - The rural-urban income gap: Per capita consumption by rural-urban *(Source: Lao National Statistics Bureau, 2014)*

Measure of average consumption	Nominal monthly consumption in LAK per capita: 2012/13			Annualised growth in real per capita consumption (%)					
				2002/3-2007/8			2007/8-2012/13		
	Rural	Urban	Lao PDR	Rural	Urban	Lao PDR	Rural	Urban	Lao PDR
Median consumption	270,966	399,391	301,660	1.3	1.0	1.7	1.5	3.3	1.9
Mean consumption	323,079	588,549	399,610	2.3	1.8	2.6	1.0	3.7	2.0

Median monthly consumption in 2012/13 was LAK 270,966 per capita in rural areas, and LAK 399,391 in urban areas. The extent to which higher consumption levels in urban areas are an indicator of better living standards is uncertain, given the higher living costs and limited opportunity for personal food production there. Consumption grew in a much faster pace in urban than in rural areas.

Poverty, culture, and ethnicity are closely linked. There is a strong correlation between poverty and those ethnic groups that traditionally have been dwelling in remote rural areas. Often due to their remote location, ethnic minority populations have comparatively less access to markets and public services such as health, education, agricultural extension, telecommunication and road infrastructure. The central government's attempts to improve the living conditions in rural areas has led to substantial changes in the livelihood of the affected population. Measures like the restriction of slash-and-burn cultivation - most uplanders' traditional main occupation - resettlement and village consolidation have proved to be challenging, and members of ethnic minority groups continue to lag behind urban dwellers.

Table 7 - Poverty headcount rate by ethnicity of the household head *(Source: Lao National Statistics Bureau, 2014)*

Ethnicity	Poverty Headcount Rate				Distribution of the Poor				Distribution of Population			
	2003	2008	2013	Change	2003	2008	2013	Change	2003	2008	2013	Change
Lao Ta	25.1	18.4	15.4	-3.0	49.6	44.0	44.2	0.2	66.4	66.0	66.7	0.7
Mon-Khmer	53.7	47.3	42.3	-5.0	33.5	36.9	40.3	3.3	20.9	21.5	22.1	0.6
Chine-Tibet	40.0	42.2	16.4	-25.8	4.0	4.8	2.4	-2.4	3.3	3.1	3.4	0.2
Hmong-Lu-Mien	45.8	43.7	39.8	-3.9	11.5	13.9	12.1	-1.8	8.4	8.8	7.1	-1.7
Other	48.1	22.0	33.1	11.1	1.5	0.5	1.0	0.6	1.0	0.6	0.7	0.1
Lao PDR	33.5	27.6	23.2	-4.3	100	100	100	0.0	100	100	100	0.0

Mobility is intrinsic to Lao culture. In the face of high uncertainty, mobility has always been a feature of Lao society. Especially highland villagers would simply relocate their village to a space with better living conditions. War-time destruction and extensive government resettlement into consolidated, easier accessible villages have affected the vast majority of upland villages. Traditionally, young men would travel and earn money and experience away from home, or were drafted for military service. Nowadays improved connectedness contributes to increasing the scale of migration, which also includes unmarried girls and women. Individual migration occurs from two main areas: inhabitants of Northern Laos, many of them from ethnic minorities, migrate to the Vientiane area. In Southern Laos, lowlanders migrate to Thailand for work. Migrant work has become a substantial source of income in many rural households. 11% of all households received remittances in 2012/13[38]. The households with income from remittances had far lower incidence of poverty than households without remittances.

Gender Inequality is highest in the region, due to poor maternal health data. Compared to its neighbouring countries, Laos has the lowest Gender inequality index score (indicating highest inequality between genders). Although participation of women in the public sphere and in the labour force is high, poor maternity conditions especially in remote areas are weighing it down. Few ethnic groups vest decision-making power solely into the hands of men.

Although not equal in all aspects, women, especially in lowland societies, do enjoy respect. Women are considered as caretakers of the family's wealth and a majority of small and medium enterprises are run by women. However, few women actively participate in politics. Moreover, women of ethnic minorities in rural areas are still disadvantaged by their work burden, their restricted mobility and low level of education.

2 FINANCIAL SECTOR OVERVIEW

2.1 Overview of the Retail Sector

Table 8 - Financial sector data

	Lao PDR				Cambodia	Myanmar	Thailand	Vietnam
	2004	**2009**	**2013**	**2014**				
M2/GDP *(%)*	20.30	32.43	50.52	56	53.6	n/a	134.5	117.0
Commercial Bank Deposit/GDP *(%)*	18.2	25.82	46.17	49	46.21		84.08	118.10
Commercial Bank Credit/ GDP *(%)*	n/a	18.68	42.82	43	43.74	n/a	82.13	103.6
Commercial banks LAK deposit ratio to total deposit *(%)*	32.0	34.89	48.62	50				
Bank branches p. 100.000 inh. *(No.)*			2.73		4.76	2.57	12.16	3.72
ATM p 100,000 adults *(No.)*		4.77	17.85		8.46	0.57	104.32	22.29
Deposit accounts p 1,000 adults *(No.)*			400.01		172.67	159.14	1509.80	n/a
Loan accounts p 1,000 adults *(No.)*			67.97		37.66	1.32	392.65	n/a

Recent History of the Financial Sector in Lao PDR

Historical background: Between 1975 and 1988, like most communist countries at the time the Lao PDR had a single-bank system consisting of the State Bank of Lao (SBL). In its early years, the Lao government had an isolationist and state-directed approach, where banks' main function consisted in lending to state-owned enterprises at sub-market interest rates, commonly with poor repayment rates.

Ever since the shift towards a market economy through the adoption of the New Economic Mechanism in 1986, the government has been continuously reforming its financial system in order to adapt it to the requirements of a market-based economy in a global context. Reformation took place as a slow process of learning and continuous re-negotiation between the financial sector and stakeholders within the party and the government.

In 1988, commercial banking activities of the SBL were separated from its central banking functions and three of its branches were spun off as independent banks. The Central Bank Law from 1990 established the Bank of Lao PDR (BoL) as the central bank, in place of SBL (improved to the Law of the Bank of Lao[39] in 1995). Up into the late nineties, the dominant state-owned banks (SOBs) remained in a state of permanent loss making, requiring regular refinancing via governmental budget funds. Large government budget deficits led to hyperinflation in the late 1990's with devastating effects on the monetary system.

In 1998, the then seven existing SOBs were merged into the Banque pour le Commerce Exterieur Lao (BCEL), the Lao Development Bank (LDB), and the Agricultural Promotion Bank (APB), which all exist to date. In 2007, the Nayoby Bank (NB) was split off from APB as a specialised bank with the particular task to channel subsidised credit into the 72 priority districts identified as poorest during the 2003 NGPES.

The 2007 global financial crisis left the financial sector in Laos largely unaffected, given its small size and absence of international linkages at the time.

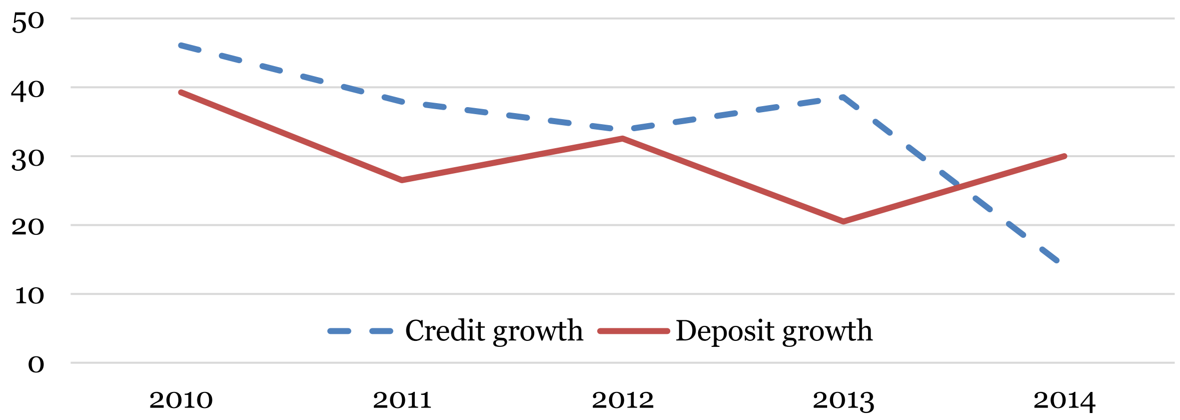


Figure 10 - Bank lending 2010 – *2014* *(Source: BoL Annual Economic Reports 2010 – 2014)*

It is only over the past decade that the government has actively paved the way for the development of a fully-fledged banking system by re-orienting its SOB to operate on a commercial and competitive basis. Financial sector growth rates have since been high. Credit disbursed by commercial banks experienced growth rates between 35% and 50%, before dropping to 14% in 2014. Despite the current modern features of Laos' financial system, aspects of the former soviet-style system – such as frequent state interventions and lack of transparency - are still inherent.

The reformatory course on financial and monetary policies has gained momentum. Domestic monetary policy is challenging in a small and highly dollarized economy, however exchange rates have remained favourable for the national currency amidst an on-going process of de-dollarization. Inflation has been steadily reduced, and stable economic growth has been achieved despite the global financial crisis. However, experts warn of the considerable remaining intrinsic risks to the Lao financial and economic system[40].

Present Status of the Financial Sector

The financial sector in Laos is relatively small compared to wealthier countries with larger populations, however the sector has been rapidly developing within the last decade.

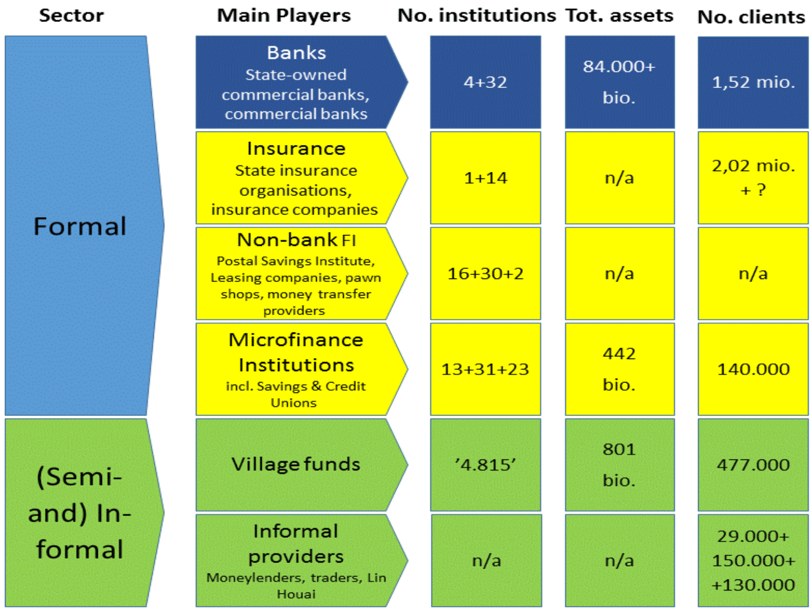


Figure 11 - The financial sector in Lao PDR *(Source: BoL, banks' financial statements 2014[41], National Economic Research Institute, 2015, FinScope, 2015)*

Dominated by banks. The financial sector is dominated by the banking sector both in size and outreach. The *microfinance sector occupies only a small share of the market*. Formal microfinance institutions (MFIs) have only been developing within the last decade, after the first Microfinance regulations have been issued in 2005. The market share of these MFIs is small, but increasing.

Village funds are ubiquitous in Laos. Almost every village in Laos has been endowed with a village fund that was initiated either by a development project or a government agency. Due to villages' high autonomy and lack of supervision, information on the actual status and especially the operational performance of village funds, is very unreliable. The data presented in this section is from a recently published survey based on 2013 data[42].

By essence no reporting data is available for the informal sector. Informal lending for commercial purposes is illegal in Laos, but nevertheless very common and mostly tolerated by the authorities.

2.2 The Banking Sector

Sector Overview

Table 9 - Banking sector cornerstone data *(Sources: BoL, banks' financial statements 2014, FinScope, 2015 Nayoby, 2014)*

	State-owned Banks (w/o LDB)	Joint Venture State Commercial Banks	Private Banks	Subsidiary Banks	Foreign Commercial Bank Branches	Total
Branches	64	5	9	11	1	90
Service Points	292	25	73	31	2	423
ATM	527	65	194	68	8	862
Webbank	2	1	1	1		5

	State-owned Banks (w/o LDB)	Joint Venture State Commercial Banks	Private Banks	Subsidiary Banks	Foreign Commercial Bank Branches	Total
Points of Sale (POS)	n/a	n/a	n/a	n/a	n/a	2,630
Loan Outstanding (in LAK bio.)	15,623	4,775	5,873	1,923	23,098	51,292
Market Share Retail Credit (%)	84%	3%	3%	6%	0%	100%
Total Assets (in LAK bio.)	30,838	7,637	9,943	3,732	32,148	84,289

As of April 2015, there are 38 banks in total, comprised of 4 State-owned banks, including the state-owned Policy Bank, 3 joint-venture state commercial banks, 7 private banks, 4 subsidiaries of foreign banks and 20 foreign commercial banks branches (see Table 9, for a complete list see Appendix D). Most of the banks with foreign origin, in particular the foreign bank branches, are launched to support foreign investors from their specific countries of origin. Most have been established within the last 5 years, making it difficult to assess their potential and strategy.

Although foreign commercial bank branches are about to overtake the state-owned banks in terms of total assets and loan outstanding (Figure 12), they are not engaged in retail lending.

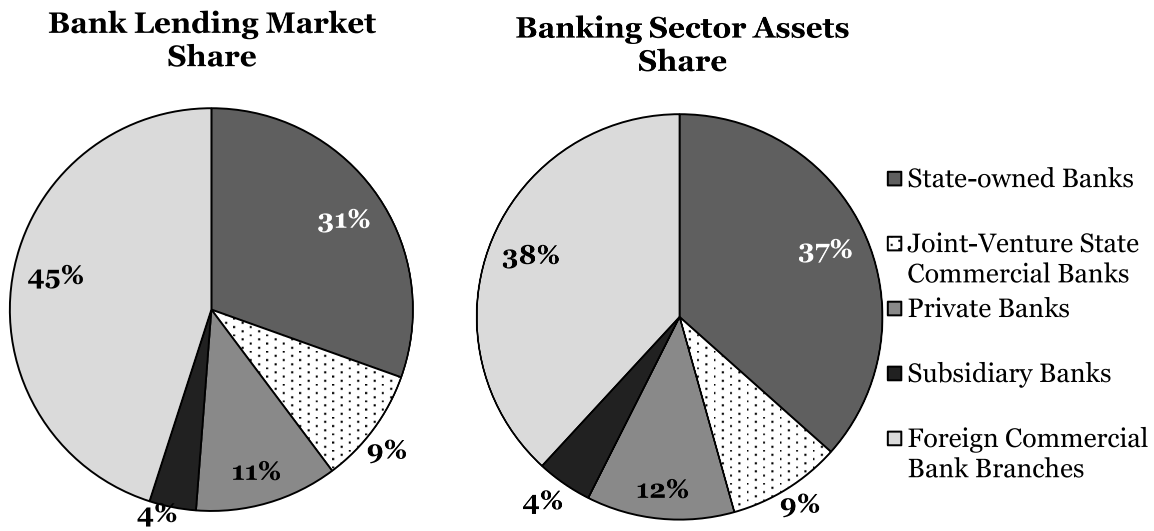


Figure 12 - Banking sector assets and lending shares *(Source: Banks' financial statements, 2014)*

The market shares on retail savings and retail credit according to FinScope results are depicted in Figure 13: **Error! Reference source not found.**they document the domination of the retail market by the SOBs, especially when it comes to credit (in spite of the notable absence of BCEL in retail lending). The

Nayoby (policy) bank enjoys good coverage in remote areas.

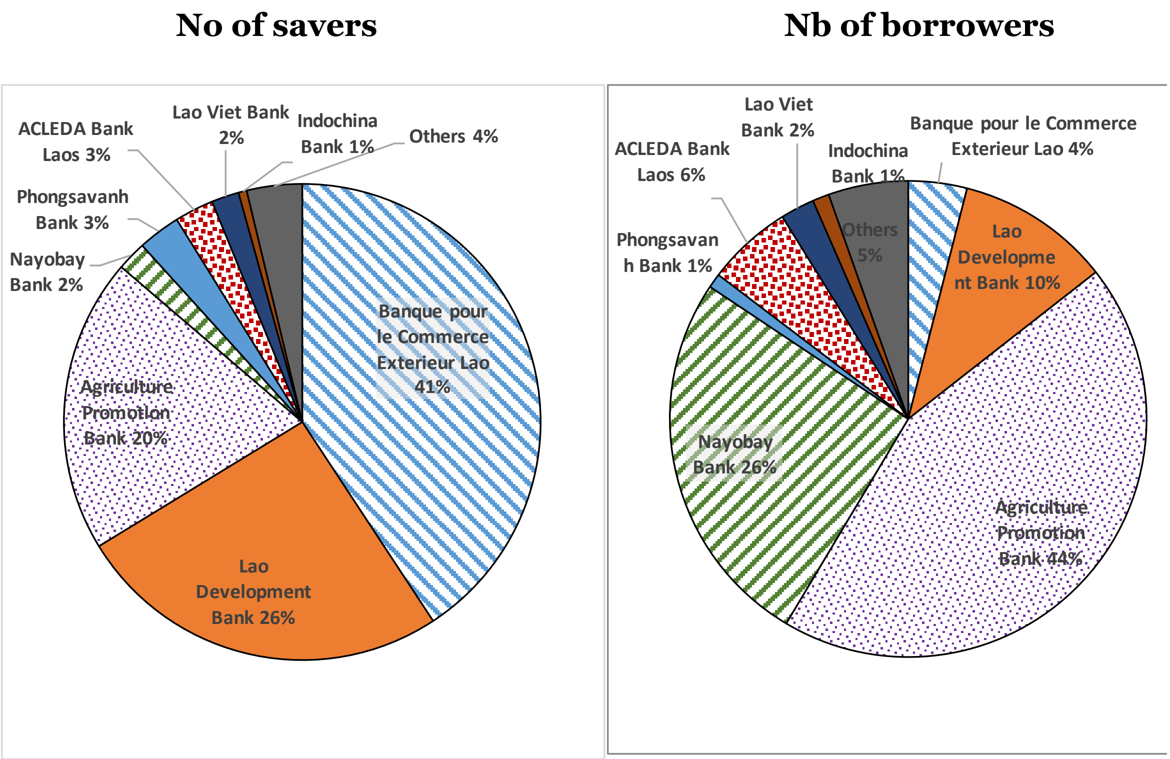


Figure 13 - Credit market share of banks *(Source: FinScope, 2015)*

State-owned Banks

The Banque pour le Commerce Exterieur Lao Public (BCEL): From 1976 to 1989, the BCEL was a specialized branch of the formerly State Bank (Central Bank) of Lao PDR and was assigned the monopoly of and was solely limited to international banking activities. Since 1989 BCEL is operating as a state-owned bank (SOB). The Government of Lao holds 70% of BCEL's shares, while local investors, strategic partners and other foreign investors each hold 10% of shares. BCEL has four joint ventures, consisting of three banks and one insurance company[43]. BCEL absorbs a considerable part of savings deposits, and is the market leader for domestic and international transfers. On the credit side, BCEL mainly targets corporate customers. Being the largest bank in Laos, BCEL has often been the market pioneer for new products and distribution channels. BCEL is the only non loss-making SOB.

The Lao Development Bank (LDB): The Lao Development Bank is the result of a 2003 merger between two regional SOBs, the Lao May Bank and the Lane Xang Bank. LDB has originally been assigned the responsibility to finance Small and Medium Enterprises (SMEs).

The Agricultural Promotion Bank (APB): The Agricultural Promotion Bank was founded in 1993 as the country's policy bank for rural development. For many years, APB had a notorious reputation for its poorly performing subsidised loan schemes. With heavy support from ADB and other donors from the mid 1990's, APB renewed its efforts to upgrade its poor performance. As a part of these reforms, policy lending was split off in 2008 into the Nayoby Bank; the remainder of APB is now meant to operate on commercial terms. However, APB is still engaging in policy lending in some areas where the Nayoby Bank is not presently operating.

Nayoby Bank, the Policy Bank (NBB): 'Nayoby' is the Lao word for 'policy'; it is an ambiguous word that contains the meaning of 'relaxation of conditions for persons in need'. It has taken over part of APB's policy lending operations and has additionally assumed the mandate to carry out subsidised lending schemes in priority areas, consisting of 72 districts identified as the poorest by the NGPES in 2003. It is presently in the process to expand beyond the previous priority areas to all districts nation-wide. NBB offers loans based on a group lending model and up to 30 mio. per family with a run time up to 5 years; the interest rate ranges from 5% p.a. for one-year loans to 7% p.a. for 5-year loans. NBB does not accept deposits, and does not carry out payment services for the public. Compared to previous schemes run by APB, NBB's lending schemes have achieved a substantial penetration in rural areas. Increasingly, the NBB also serves corporate agribusiness customers both within and outside of its mandate. Recently, National Assembly members *'called on the Bank of the Lao PDR to enhance its guidance of the Nayoby Bank in revising its loan structure to release loans to the real producers, especially farmers, while penetrating each family rather than releasing large amounts of money to an individual or individuals*[44].

Despite their original separation of responsibilities, state-owned banks have shifted to full-fledged competition with, for example, the APB operating service points in urban areas, the LDB servicing rural customers or the Nayoby Bank and the APB campaigning in the same villages.

Private and Subsidiary Banks

Laos' oldest private bank, the Joint Development Bank. Founded in 1989, the Joint Development Bank (JDB) was the first private bank in Laos. Originally a joint venture between a Thai investor and the BoL, JDB is now owned entirely by 3 Lao shareholders. It has been expanding its banking network from only 4 service units in 2011 to 26 service units across the country in 2015, except in Phongsaly and Saysomboun provinces. JDB serves the corporate and SME segments, with retail lending restricted to its own staff. JDB wants to consolidate its operations in the SME segment, but currently has no actual plans to expand retail lending.

The Phongsavanh Bank, Laos' largest private bank. The Phongsavanh Bank is part of the Phongsavanh Group, a multi-sector conglomerate with enterprises in international trading, timber, hospitality, telecommunications, banking, airlines and security products and services, owned entirely by one investor. The bank is comprised of 4 branches and 33 service units. The bank has mostly individual (75% of its total customers) and small corporate customers (25% of its total customers) with a focus on SME lending products. It has a plan of further downscaling into the low-end segment, where there is presently little competition from other banks except ACLEDA.

ACLEDA Bank Lao, established by a successful Cambodian microfinance bank. ACLEDA Bank Lao Ltd. is a subsidiary of the Cambodian ACLEDA Bank Plc. It started its operations in 2008 with the clear mission to provide financial services to small and medium enterprises under high professional standards. Initially the bank was, as a foreign-owned institution, prohibited by prime minister notice[45] to have operations in the microloan segment. This restriction is no longer in effect, and ACLEDA is pursuing a clear strategy for downmarket expansion. ACLEDA is the only non-state owned bank that is presently expanding into rural areas. All other banks consider urban markets uncrowded, and thus have no immediate incentive to penetrate the rural market. ACLEDA's strive towards importing sound banking practices into Laos, including customer-centric, corruption-free services, transparency and low loan portfolio-at-risk, has an exemplary effect on the sector.

Performance of the Banking Sector

Loan portfolio performance has been very poor, but is gradually improving. For many years, the government has been in denial in regard to the banking financial sector's difficulties with Non-Performing Loans. Repayment discipline has traditionally been poor, especially for lending to state-owned enterprises and recipients of soft loans. The fact that only up to 0.5% of the Loan Gross Portfolio were accepted as tax-deductible loan-loss provisions failed to incentivise banks to do address this issue. In 1996, six prudential regulations for commercial banks were issued, and a new regulation on asset classification and loss provisions was promulgated in 1998. Subsequent reforms were carried out, resulting in a slow but steady improvement of the financial sector's performances.

However, BoL's definition of NPL and NPL-related banking practices, do not meet international standards. Financial Institutions' awareness about sound practices and their capacity to apply them has been growing alongside increasing pressure from the central bank. It is part of the political culture to set high targets. The present upper target for NPL is 3% for commercial banks and 5% for MFIs. However, few Financial Institutions' transparency levels prevents effective reporting of potential issues; in many cases, financial reports and published data are not reliable. Reportedly, it is general practice for banks to deduct the annual interest amount from the payable credit amount and to deposit this amount on a separate account for payment at due time. Thus, interest payment is secured at the maturity of the loan.

Unpaid principal due at the time of maturity can be transferred into new, restructured loan contracts, that are not categorised as NPL[46]. This method enables the banks to report low NPLs, although it effectively blurs the main purpose of NPL reporting to assess loan repayment behaviour and bank's risk profile.

The reliability of the reported data of both banks and the central bank is unreliable, and reported rates do not reflect the actual loan portfolio risk situation within the banking sector.

Banking business in Laos can be profitable, but performance varies. Reporting banks' Return on Assets (RoA) in 2014 varied widely between -16.57% and+2.06%[47].

2.3 Non-bank Financial Institutions

Sector Overview

The subsector of Non-bank financial institutions in Laos is comprised by 1 institution with special license, 13 Deposit Taking Microfinance Institutions, 31 Non-deposit Taking Microfinance Institutions, 23 Savings and Credit Unions, 2 Staff Savings Institutions, 30 pawn shops and 16 specialised leasing companies (see

Table 10), for a complete list of Microfinance Institutions see Appendix E. All are under the supervision of the central bank's Financial Institutions' Supervision Department.

Table 10 - Non-bank financial institutions' cornerstone Data *(Source: BoL Statistics processed by MAFIPP)*

	Special License & Staff Savings Institutions	Deposit taking Microfinance Institutions	Non-deposit Taking Microfinance Institutions	Savings and Credit Unions	Leasing Companies	Pawn Shops
No. Of institutions	3	13	31	23	16	30
Loan/Leasing contracts Outstanding (in LAK mio.)	n/a	148,029	59,770	35,585	130,796	3,305
No. Of customers deposit/credit	n/a	107,755/ 24,686	29,573/ 11,464	21,798/ 5,387	7,567	1,078
Total Assets (in LAK mio.)	n/a	192,136	81,231	51,530	n/a	n/a

Microfinance Institutions

Licensed Microfinance Institutions only developed since 2006. After the issue of the first Microfinance regulations in 2005, the first Microfinance institution, the Ekphatthana DTMFI, was licensed in 2006. Microfinance Institutions are categorised into Non-deposit Taking MFI (NDTMFI) and Deposit Taking MFIs (DTMFI). Since then, the number of MFIs has grown steadily, but their market share remains low. Most MFIs are small in size, with only two presently having reached economies of scales.

Most MFI are operating with limited scope and ambition for growth. A majority of MFIs, founded by wealthy individuals, are operating with limited scope and ambition for growth. MFIs' main business strategy focuses on short-term credits where the interest rate is secondary to liquidity and timely disbursement, and other non-bankable credit purposes. With a few exceptions, MFIs occupy small niches, often limited to geographically close markets. Few of them are expanding beyond their area of origin, or into rural areas.

Few MFIs strive – successful MFIs differentiate themselves with active development into new markets and innovative products. Despite remarkable growth rates of the microfinance institution segment[48], this growth has been concentrated on two Deposit-taking MFIs, the Ekpatthana DTMFI (EMI) and Saynyaisamphanh DTMFI, which both account for 69% of total assets of all DTMFI. In contrast to the majority of MFIs, the group of expanding MFIs is very proactive in developing new, innovative products to formerly underserved segments[49].

Village fund Network Support Organisations. The village fund network support organisations include all Non-deposit Taking MFIs, which are significantly different from other financial institutions. They are multi-purpose organisations providing both financial and non-financial services to their corporate members, the Village Banks. All except one of them have been initiated by the German project 'Access to Finance for the Poor' (AFP). Their main financial business consists of facilitating liquidity exchange between member village funds.

Microfinance institutions suffer from multiple constraints. All Savings and Credit Unions (SCU) and MFIs are suffering from heavy competition from informal finance and village funds on the one hand, which are operating faster and under more flexible conditions, and on the other hand from the banking sector with its increasing efficiency and outreach. Deposit-taking MFIs face constraints in mobilising deposits; furthermore they face considerable risk premiums to depositors, as banks are seen as the safest place to deposit savings[50].

Moreover, microfinance institutions are under more restrictive regulations than banks.

Savings and Credit Unions

Savings and Credit Unions. The 3 first Savings and Credit Unions (SCU) were created with ADB support in 2004 under a draft regulation for Savings and Credit Unions. FISD, backed by ADB, SNV and ACCU, conducted a campaign to motivate existing Village Funds to register as SCUs. With intensive support, 20 more local community funds obtained an SCU license and brought the total number of SCUs up to 23. SCUs are small in size and occupying local niche markets. Their governance structure and local anchorage set them in proximity with Village Banks, from which a majority of them originate.

Similar to Village Banks, a majority of SCUs struggle with enforcing repayment, which results in high levels of Portfolio At Risk (PAR). Strong local competition from village funds and banks is curbing SCUs' growth potential. Attempts to upscale their approach to gain on village funds' market shares have failed so far. SCUs' set up and running of operations are far more demanding compared to the Village Bank network approach, and only few of them show good financial performance, despite significant capacity building efforts.

Pawn Shops and Specialised Leasing Companies

There are 30 registered pawn shops, most of them located in Vientiane, which are negligible in terms of size and market share.

The leasing sector in rapid development. Leasing by traders and shops without a leasing license has been practised in Laos for many years. Since 2009, 17 specialised leasing companies have been licensed with the Bank of Lao, with one license revoked since.

Within the last two years, the emergence of several leasing companies with foreign ownership and expertise on the market has positioned formal leasing as a growing part of the financing sector in urban areas.

A substantial amount of vehicles in Laos are leased, a market in which the main leaders are Indochina Bank (in cooperation with Korean car manufacturers), Krungsi Leasing Ltd., as well as car dealers (without leasing license). Aeon Leasing Ltd. has recently entered the market for leasing of mobile phones and electric appliances. In competition with Krungsi Leasing Ltd, it has built a network of agent dealers of high end products.

A number of agricultural cooperatives also provide credit to their members

Performance of Non-bank Financial Institutions

The performance data in Table 11 is based on reporting to the central bank, and the uncertainty of its reliability should therefore be considered.

According to these data, in average microfinance institutions and SCUs have less repayment issues and a higher return on invested capital than banks. However, a number of institutions were not reporting at all[51]. The data reveals large variations between the best and the worst performing institutions, reflecting the potential profitability of the sector but also the instability of a number of institutions.

Table 11 - Performance data for non-bank financial institutions *(Source: BoL Statistics, processed by MAFIPP)*

% (spread)	Non Performing Loans (PAR_{90})	Return on Assets
Deposit-taking Microfinance Institutions	0.94% (0.35% - 6.68%)	2.89% (-7.73% - 17.67%)
Non-deposit Taking Microfinance Institutions	0.80% (0 – 11.84%)	10.10% (-52.92% - 38.66%)
Savings and Credit Unions	1.56% (0 – 19.42%)	5.71% (-19.52% - 16.40%)
Leasing Companies	n/a	-3.77%

2.4 De-facto Unregulated (semi-formal) Institutions

The Emergence of Village Funds in Laos

Initial focus on revolving funds and credit. Since the early 1990's, community-based village funds[52] have been set up in a large number of villages. Non-deposit taking village funds have predominantly been set up by development projects in the 1990's and early 2000's, focusing on the provision of low-interest credit for income-generating activities. Many development projects have attempted to address the perceived lack of funds for villagers' income-generating investments by setting up grant-financed village revolving funds, either in kind or in cash. Additionally, Payments for Environmental Services (PES) and compensation payments have been used as incentive to initiate credit-based village funds.

The development of savings-based village funds. Since 1997, two Thai NGOs, the Foundation for Integrated Agriculture Management (FIAM), and the Community Organizational Development Institute (CODI), were the first to promote savings-based deposit, targeting village funds in lowland villages with good social and economic potential. The two organisations have been operating in partnership with the Lao Women's Union, and deposit-taking village funds subsequently became the standard approach for mass organisations to set up village funds. Village funds with a strong savings component have since been integrated into numerous international organisations' strategy to provide unbanked people with access to organised financial services, including in areas with little economic activity and potential.

Number and Outreach of Village Funds

Low data reliability. As village funds go unregulated and largely unsupervised, data on village funds is extremely unreliable. Most of the village fund promoters that have been the source for the data presented here, from the NERI Microfinance surveys 2009 and 2015, are not in regular contact with their village funds. Data is not updated or validated regularly and in many cases is simply copied from previous reports.

Reporting standards are low with few included variables. Information on loan portfolio quality is only available from Village Banks within the AFP network. An unknown, high number of reported villages is likely to no longer be operative due to mass delinquency. Furthermore, there are data gaps in terms of the listing of village funds in the survey.

Table 12 – Data on village funds *(Source: NERI, 2010, NERI, 2015.)*

	No	No of clients/ members	No of borrowers	Total Assets (LAK mio.)	Total loan portfolio outstanding LAK mio.)	Size average loan (LAK)
Village Funds (2009)	4,113	359,608	172,612	399,020	245,729	1,423,592
Village Funds (2013)	4,815	464,256	171,137	801,583	587,729	3,434,254

Village funds have high outreach. Village funds have obtained high outreach due to their simple structure embedded into local social traditions, their adaptability to different economic and cultural contexts and their easy replicability. Established and well-operating village funds are absorbing a significant part of the demand for financial services by low- and medium income segments of their communities, including in urban areas. As seen in Table 12, they have been able to double their assets within a 5-year period, driven mainly by the mobilisation of savings. An estimated 10% of adults are saving in village funds, and 26% declare to be members, taking into onsideration that the majority of village fund accounts are household accounts.

Structure and Legal Status of Village Funds

Village funds share a similar structure, which is adapted to local conditions. All village funds share a common, almost identical governance structure, based on the members' assembly that meets at least once a year. The executive committee is responsible for day-to-day operations and decisions concerning the fund. It is elected by the members' assembly, and typically consists of the president, a cashier, a credit accountant, and, where applicable, a savings and a ledger accountant. So-called village fund advisors, who are typically well-respected individuals within the community, are assigned for supervision and problem-solving, though normally not being involved in day-to-day operations.

Depending of the village fund's scope of operations, service hours differ from daily to annual, with 1-2 adjacent regular monthly service days being the standard. Village revolving funds offer credits under the founding agency's defined conditions, which largely focus on income-generating activities as well as emergency situations. Savings-based village funds allow for members to deposit liquid savings and take out small credits for purposes under the membership's terms and conditions. At the end of the financial period, typically one year, the profit created from interest income is divided between executives and the deposit-holders/shareholders according to a pre-agreed ratio[53].

The government enabled all villages in Laos to have a village fund. As mentioned previously, the government's financial policy includes the establishment of village funds in all of its villages according to its 'Developed Villages' policy. Village funds also reach urban communities with well-developed formal services, where some village funds have succeeded in filling supply gaps, in particular for low- and medium-income citizens. Some of these urban or semi-urban village funds have reached a substantial size, especially when compared to the size of licensed microfinance institutions.

Although not registered with the central bank, village funds have formal attributes. Village funds have been classified as informal for the purpose of the FinScope consumer survey, as they are presently unregulated or unsupervised in relation to the Bank of Lao. The legal status of village funds is unclear, as they do possess a formal identity; for example most village funds own an official permit by the district governor. Village funds can also open bank accounts, although it is unclear whether the jurisdiction considers them as legal entities.

Governmental responsibility for village funds remains unclear. Although overall responsibility for village funds is placed under the central bank by two prime minister instructions[54], in practice the central bank has not implemented this responsibility yet. Even though village funds are required by law to register to obtain a license as microfinance projects since the first microfinance regulation has been issued in 2008, no village fund has registered in practice. A nation-wide supervision structure for village funds exists within the National Committee for Rural Development and Poverty Eradication, however, there is no evidence of its functioning. At the local level, the Rural Development and Poverty Eradication Office (RDPEO) or, in city areas, the Lao Women's Union (LWU), have effectively taken over the responsibility for supervising and supporting village funds. This supervision is most often done unsystematically, irregularly and lacks technical skills.

Potential Challenges

Advantages and challenges. Village funds' advantages lay in their potential for expansion, cost-effective set-up and their outreach to clients at the financial frontier. However, they also meet serious challenges. Without sufficient support and supervision, most village funds experience issues with elite capture, fraud and/or mass delinquency. Poor accounting practices without reconciliation of accounts and incomplete recording of basic transactions are widespread. Lenient credit management and the failure of the executive committee to enforce internal regulations often lead to a gradual decline in income from interest payments. Liquidity decreases as loans are not repaid. These factors contribute to a decrease in deposits from members. In some cases the committee is successful in confining delinquency, and attracting additional savings on the basis of relatively attractive dividends. However, as bad loans remain unaddressed, these funds, despite their good liquidity, end up being insolvent.

2.5 The Informal Financial Sector

Moneylenders operating at the community level were common, especially in lowland communities. However emerging alternatives, especially Village Funds, where operating well, effectively take small-scale moneylenders out of business[55]. It is assumed that their significance is reduced to few areas, which have not yet developed reliable alternative credit sources.

Informal leasing and trader credit remain significant. Unfortunately, leasing was not covered by FinScope's surveys. In practice, credit down payments and leasing schemes are rarely differentiated during data collection, and part of leasing may have been reported as 'goods in advance of payment'. Field observation and qualitative interviews revealed that informal leasing and instalment sale of household items are widespread. These have become the main source of credit for many households. Hawkers, mostly Vietnamese, travel from village to village, including remote rural areas, with fully loaded motorbikes or bicycles to sell household goods on instalment plans. Lao and Chinese shop owners sell goods for subsequent settlement. Leasing is also widely used by shops selling vehicles, machinery and other high-value items. According to the law, they are required to obtain a license as leasing companies, but no request has been registered. In the visited areas of Southern Laos[56] 75-85% of all households in the area reported currently owing money for leased household goods or agricultural inputs. They stated that 50% and more of the income from their agricultural products' harvest went to the settlement of debts that were taken out during the lean season. Another survey[57] among rice farmers revealed trade credit as the prevalent source of credit, used by 40% of respondents, followed by lending from village funds (25%); 10% had a bank loan, and 38% had no credit experience.

Various other sources of credit exist. These include contract farming, informal sources of business funding and traditional rotating savings, and credit associations. Data on these sources of credit is poor, part of which were not explicitly explored by FinScope. Furthermore it is uncertain whether other forms for credit were understood as such by FinScope respondents.

Contract farming has become a widespread form of financing for certain agricultural commodities with a long-term scope and unsecure marketing conditions. Besides the set-up of large-scale plantations run by foreign investors, a number of local farmers have set up private plantations of rubber, coffee, tea, sugar cane or cassava, often in cooperation with a foreign investor. Typically, traders or processing companies share the initial investment costs with the farmer, in exchange of conditions on the sale of the agricultural product. For rubber plantations, the most common arrangement is the 2+3 model. The farmer manages land and provides labour, while the investor is responsible for inputs, technology and marketing. The farmer typically receives 60-70% of the rubber revenues, the investor the rest. A simpler model is the 1+4 model, where the farmer only places his land at the disposal of the investor, who is then in charge of the input of labour[58].

For coffee and tea plantations in Southern Laos, no such contracts were found. Instead some trading companies provided interest-free prepayments to finance the labour-intensive harvest of coffee or tea.

Large enterprises also turn to informal networks for lending of large amounts of money, in particular for bridging urgent liquidity gaps; the lenders are usually wealthy private individuals or other enterprises.

Traditional Rotating Savings and Credit Associations, called 'Lin Houai', are mainly operating in crowded markets, and were once the most common financing mechanism in Laos. Savings are collected from the participants and lent to the highest bidder to often very high interest rates. Reports on their current presence differ widely. According to FinScope, 4% of adults were members of Lin Houai.

The informal financial sector is filling the supply gaps left by the semiformal and formal sector. Field work observations informed a link between the occurrence and significance of informal finance and whether there is a gap between the demand created by emerging economic activities and the supply of relevant financial services by formal or semi-formal institutions. With an emerging demand from increased monetary activity, informal activity involving moneylenders, shops and mobile traders are often the first providers of financial services. Successful operations local village funds are reported to be very effective in reducing other informal saving and lending activities.

2.6 Payment Services Providers

The historical importance of the Lao Postal Services for domestic remittances services. For many years, the Lao postal services - Entreprise des Postes Lao - was the dominant provider for domestic remittances services, because of its simple and inexpensive product. It used to be the only money transfer provider with a network covering all districts in Laos.

Western Union and Money Gram for international remittances. Remittances from relatives living abroad once were a substantial part of many families' scarce cash income. The two specialised international money transfer providers operating in Laos - Western Union and Money Gram – dominated the market in the 2000's[59]. Their network of agents – banks and the Lao postal service – and shops or private persons acting as subagents covered large parts of the country, including beyond the capital district level. Their market share has decreased alongside the development of cheaper and more convenient bank transfers, and the decline of remittances from relatives abroad.

Banks have taken over the main market share. With the growing number of account holders, and low bank transfer fees, banks have increased their market share of domestic as well as international payments.

Informal providers occupy special niches. Informal payment services offered by private persons with banking networks on both sides of the Thai-Lao borders are used for trans-border remittances. A well-informed source[60] estimates that up to 80% of remittances from Lao migrant workers in Thailand are remitted informally.

A National Payment System is still under development, and the central bank has little part in domestic money transfer. Although a Real Time Gross Settlement (RTGS) system is operated by the BoL, it is almost unused. Banks continue to settle the bulk of their payments on a bilateral basis. BoL's Clearing House is used for clearing interbank cheques.

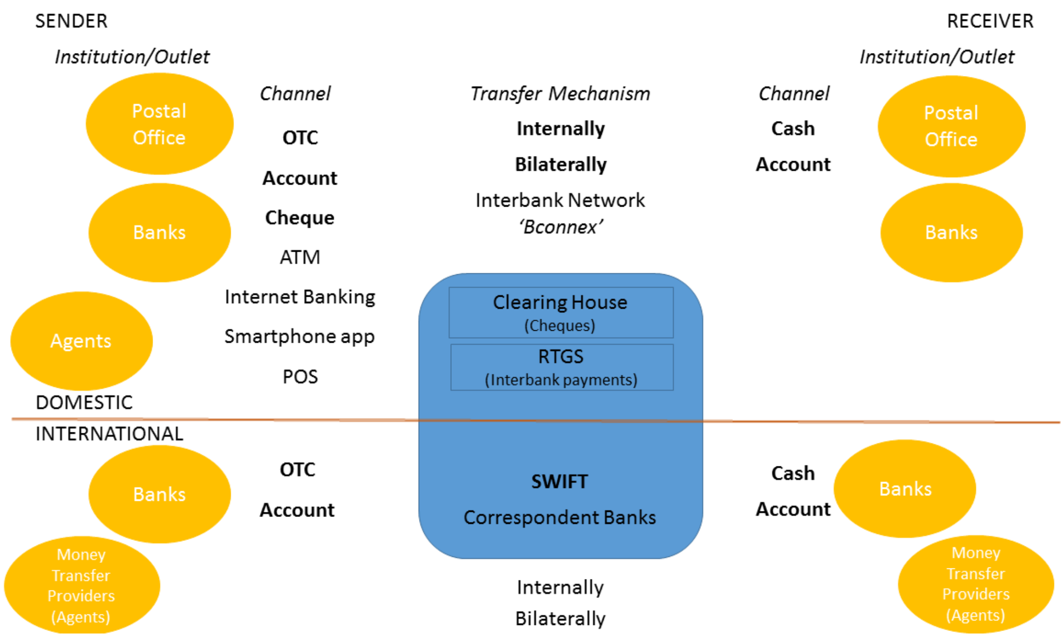


Figure 14 - The payment system in Lao PDR

Cash remains the main mode of payments. The majority of domestic money transfers, production and consumer goods payments, utility bill payments, payments for education, hospitals, taxes and social security contributions by companies and payments to beneficiaries are made through cash and in some cases through cheques.

Within the last years, both the government and large enterprises have transferred a large part of their payrolls for electronic processing. For this purpose, the Ministry of Finance (MOF) has cooperated with BCEL to open bank accounts for government employees and issuing an ATM card linked to these accounts.

In rural areas, postal services are also used, and an unknown share of government staff in remote locations continue to receive their salary in cash.

Sending money by bus or car has never played a significant role, due to lack of trust, however relatives and friends are frequently entrusted with the task to send money to relatives.

Digital financial services in Laos are in their initial stage. In 2010, Laos' largest telecommunication operator, Lao Telecom, launched an attempt to provide mobile money, which failed after only 6 months of operation. Since then, other enterprises have been cautious; in 2015, several mobile money products are currently under development. Since June 2015, BCEL is running a pilot project that offers money transfer services via local agents connected to the bank via an internet-based application. Two mobile network operators, ETL and Unitel, have been granted permission to run pilot projects, but have not yet started operation.

2.7 Insurance Companies

Currently 14 insurance companies are licensed by the Ministry of Finance. The oldest insurance company in Laos, the Assurances Générales du Laos or Allianz

General Laos (AGL), was founded in 1990 and enjoyed a monopoly until 2007. AGL is a joint venture between Allianz (51%) and the Ministry of Finance (49%), and currently still owns 70% of the market shares[61]. It targets higher income people and businesses focussing on car insurances, home, health, travel, and insurance for employers, offering an increasing range of private and corporate insurance products.

Other major insurance companies include the Lao-Viet Insurance Company, founded in 2008 and owned by the Lao-Viet Bank, the LFTB and the Vietnamese BIC Insurance Company; it has a target group and product range similar to AGL. Tokojaya Lao Assurance (Toko) was founded in May 2007 (80% owned by a Malaysian conglomerate and 20% by the Ministry of Public Security). The Lane Xang Public Insurance has been established in October 2011 as a joint venture of LDB and the Vietnamese Post & Telecommunications Joint Stock Insurance Corporation.

Four public health insurance and social security schemes, which respectively target employees of the public and the private sector, and poor and rural households, have recently been transferred under the responsibility of the Social Security Fund Office (SSFO). The SSFO is regulated and supervised by the Ministry of Labour and Welfare (for details, see chapter 5.5 – Products and Providers).

Table 13 – Insurance companies – summary data

	Founded	**Main products**	**Annual insurance premium revenue** (in LAK mio.)
AGL	1990	▪ Property insurance: motor, home and SCB insurance ▪ Personal insurance: health, travel and life insurance ▪ Business insurance: transport, workmen's compensation and other business related insurance	229,791
Lao Viet Insurance Company	2008	▪ Motor Insurance ▪ Transport insurance ▪ Life insurance	93,216
Tokojaya Lao Assurance	2007	▪ Motor insurance ▪ Fire insurance ▪ Special Value PA insurance	n/a
PCT Asia Insurance Co., Ltd	2009	▪ Life insurance ▪ Business insurance	597
Lane Xang Public Insurance	2010	▪ Motor insurance	11,866
Thippaya Insurance Co., Ltd	2013	▪ Life insurance ▪ Business insurance	358

2.8 Financial System Support Services and Infrastructure

Support services and infrastructure enabling financial institutions to operate are under steady development.

Interest Organisations. Two interest organisations are representing two different segments of the Lao financial sector.

The Lao Bankers' Association was founded in 2001 under the supervision of the Bank of Lao. Its members include three SOCBs (excluding Nayoby Bank), State Joint Venture Banks and Lao private banks. The Association is currently chaired by the Executive Director of BCEL and one of the Deputy Director of APB acts as the Association Deputy Chair. The Association has no separate physical office and members meet irregularly. In principle, BOD meetings are organised on a quarterly basis and ordinary meetings are held every 3 years while ad hoc meetings are also organised on a call basis.

The Microfinance Association - sector organisation for microfinance institutions. The Microfinance Association started as a donor forum on Microfinance, the Microfinance Working Group, in 2007 to share experience, promote international good practices in the sector and to coordinate donor activities. Building on the enthusiasm of local microfinance practitioners, and supported by the international donor community, it was able to open a secretariat in 2011 and to gradually increase the scope of its activities.

In October 2013, the MFWG obtained its temporary license as a non-profit association (NPA), changing its name to Microfinance Association (MFA). MFA is the official national umbrella organization for microfinance institutions, representing roughly 50% of licensed MFI and 80% of the sector's loan portfolio.

The MFA's services focus on three core areas: knowledge management, research and representation; capacity building; and advocacy. Main services provided by the MFA include: organization of trainings and workshops; processing and benchmarking of MFI performance data; dissemination of information, studies and good practices relevant to the sector; representing the MF sector towards the regulatory and supervisory authority; conducting social audits for MFIs; providing information and guidance to potential (social) investors and linking investors with member MFIs.

The MFA is also emerging as the leading training provider on MFI management; upon the specific request of the Bank of Lao it has developed a Microfinance Certificate Course, which will be launched in 2015.

Tertiary education and training tailored to the financial sector. The Banking Institute (BI), founded in 1979 as a separate institution under the leadership of the BoL, is responsible for capacity building of current and future bank staff. In 2013, the Banking Institute employed 71 teaching staff and had a total of 1,200 graduates. Amongst other curricula, the Banking Institute also offers a Bachelor degree in Microfinance.

There are a number of consulting and training providers available for the microfinance sector. The Microfinance Center, has evolved from the initial UNCDF 'Microfinance and Sustainable Livelihoods' project'. CARD International, which is a member of the Philippines network of CARD MRI institutions and has been operating in Laos since 2008, is partnering with international donors as training and technical assistance provider to microfinance institutions, and has been involved in the institutional development of a large number of MFI.

Financial Infrastructure. The Depositor Protection Fund was established in 1994 under the leadership of the BoL. As per BOL regulation, all banks are required to participate in the DPF and have to pay premium on a quarterly basis.

The premium percentage varies between local and foreign currencies. For example the 0.14% premium for savings' annual average outstanding balance in LAK requires a minimum of 15 mio kip LAK, while the 0.05% premium for foreign currencies, requires a minimum of 10 mio kip.

Deposits in LAK and USD/THB are covered by the DPF, based on a range, such as LAK 1-28 mio, USD 1-1,200 and THB 1-36,000 per depositor, to be compensated in case of bankruptcy. Deposit-taking Microfinance Institutions, despite being required to be members of the DPF, have so far not been admitted.

The Lao Credit Bureau, created in 2007, ranks as a division within the Information Technology Department of the BoL. It provides credit information based on the data submitted by commercial banks. All banks are required to verify the credit history of their prospective customers, including CIB lending carried out on-line, prior to granting loans. Currently CIB is carried out on a basis of membership and user fees. Four non-bank financial institutions are presently participating, including three leasing companies and one MFI.

Services to non-bank members are performed on an off-line basis. Since BOL is promoting the use of CIB, membership and user fees for non-bank financial institutions are waived from September 2015 until the end of 2017.

Laos has a young and small stock exchange market, a joint venture between the Bank of the Lao PDR (BOL) and Korean Exchange (KRX), which opened in 2010. So far four companies have enlisted, amongst them the BCEL. The average daily trading volume in 2014 was LAK 630 mio.

2.9 Financial Inclusion Initiatives Led by Overseas Development Aid (ODA)

Initiatives including Village Funds

The first village funds were in-kind or credit-based. The concept of credit-based village funds, either in kind (cattle banks, rice banks) or monetary, was promoted by a number of development organizations that established themselves in Laos after its political opening. Numerous rural development, income-generating, climate or forest protection projects are initiating credit funds in cooperation with government partners. They constitute a mean of channelling external grant funds to local communities. Very few of them survive in the long-term after the project that instituted them.

The emergence of savings-based village funds. Current village funds emerged from a number of ODA project initiatives, some of which having had a large impact on government policies. The late 1990's also saw the development and implementation of a savings-led Village Bank approach by two Thai organisations, the 'Foundation for Integrated Agriculture Management' (FIAM) and the Community Organizational Development Institute (CODI), both in cooperation with the Lao Women's Union (LWU). Up to today, this approach has been the blueprint for the government to establish community-based savings and credit institutions. The approach has been replicated in thousands of villages, mainly by the LWU, which is perceived as the principal government organisation for village funds.

Set-up of Village Development Funds by the Poverty Reduction Fund. From 2003 to 2007 the Government allocated technical support and seed funding through the Poverty Reduction Fund (PRF) for the development of Village

Development Funds (VDF) in the country's 47 poorest districts, based on the National Growth and Poverty Eradication Strategy (NGPES). LAK 41.7 bio. of seed capital was disbursed as loans to 528 villages. These initiatives featured negative real interest rates and very low contributions instead of savings. The share of VDFs still in operation remains unknown; the National Committee for Rural Development and Poverty Reduction has the overall oversight over these funds.

Several organisations working with village funds have been developing the idea of Network Support Organisations. Between 2003 and 2008, the International Labour Organisation (ILO) initiated a total of 139 Village Banks in the Southern part of Laos. ILO aimed at improving the functioning of Village Banks and as well as building permanent second tier Village Bank Associations; the latter however didn't materialise.

The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) has contributed to the creation and support of village funds in Laos since 1998 through its Access to Finance for the Poor (AFP) programme. Its 449 Village Banks are organised in 8 licensed Network Support Organisations (NSOs) (see chapter 1.4). The AFP also has a component dealing with Financial Literacy and Consumer Protection.

Luxemburg Development, as a technical assistance (TA) provider, facilitated the development of 63 village funds, so-called Village Savings and Credit Groups, in the framework of the Oudomxay Community Initiatives Support Project launched by the International Fund for Agricultural Development (IFAD). In order to support the sustainability of village funds after the end of these projects, the Xainiyom MFI was founded in 2010 with the technical support of CARD International. Xainiyom was the first to introduce a group- saving and – lending system to Laos, based on the Grameen model. This approach has proved to be successful, and has since been replicated by a number of MFIs.

The World Bank (WB) has been involved in the set-up of community-based funds within several of its development projects, none of which being directly targeted at financial sector development. The above-mentioned Poverty Reduction Fund is financially supported by World Bank funds. Amongst other projects where village funds were part of a broad development strategy, WB provided funds for the creation of 723 Village Development Funds within the 'Sustainable Forestry and Rural Development Project' (SUFORD), (2004-2011).

The German *Deutscher Genossenschafts- und Raiffeisenverband e.V.* (Confederation of Cooperatives and Cooperative Banks – DGRV) created a network of Village Banks in Savannakhet province between 2010 and 2012. The 'Champhone Village Bank Service Center', operating as a Network Support Organisation and microfinance institution, however collapsed in the wake of a fraud case. DGRV pioneered in the field of Financial Literacy by developing a village workshop on sound financial behaviour.

Network Support Organisations. Most development projects having promoted the creation of village funds transfer the follow-up responsibility to the local district government. Due to the general lack of resources within the governmental system, this approach has not been successful, and village funds go mainly unsupported. Several initiatives have been launched to tackle this issue. In the greater Vientiane area, CODI has developed a combination of peer-to-peer support network coordinated by the district LWU. GIZ has set up rural village funds since 2000, and is currently supporting 449 savings-based Village

Banks. To ensure the sustainability of the Village Banks, 8 local Network Support Organisations (NSO) have been initiated. The NSOs are owned and governed by their member Village Banks. Their primary task is to support members with accounting, training and coaching, supervision and problem solving during monthly service visits. Accounting is done in books, with electronic copies that are processed into detailed monthly reporting, following rigorous and sound practices to avoid fraud and delinquency problems[62]. Licensed as Non-deposit Taking MFI, NSOs also provide financial services - they facilitate liquidity exchange between member Village Banks by accepting their deposits with surplus liquidity, and lend to Village Banks with unsatisfied demand for credit. NSOs also dedicate part of their portfolio to retail lending to local SMEs. AFP is currently working on integrating its NSOs into a national apex organisation.

Initiatives involving Savings and Credit Unions and Microfinance Institutions

First initiatives focusing on formalizing microfinance. In the mid-1990's UNDP/CDF initiated a microfinance roundtable to promote coordination amongst international donors. In 1996 UNDP/CDF carried out the first microfinance survey among rural households. Concluding that the dominant revolving fund approach encountered serious sustainability problems, the 1997 'Microfinance and Sustainable Livelihood Project' was prepared in partnership with BoL to build capacity and disseminate good practices. Three Microfinance Institutions[63] were established accordingly, all of them operating up to today, although on a minor scale.

Of the 3 MFIs founded by the UNDP/CDF Microfinance Project only one, the Oudomxay Development NDTMFI, has obtained BoL registration. The other two, the Sayaboury Microfinance Office and the Sihom Project Savings and Credit Scheme are still administered by the respective provincial Finance Office without a BoL license. The training capacity built under this project proved to be crucial for subsequent projects to build on.

Rural and Microfinance strategy development. With support from the World Bank, a 'Rural and Microfinance Strategy' was developed in 2003 by a Rural and Microfinance Committee consisting of representatives from relevant ministries. The Bank of Lao was endowed with the regulatory authority on the sector, and the initiative led to the development of the first Microfinance regulations in 2005.

In 2009, the German *Savings Bank Foundation for International Cooperation* (SBFIC) successfully built the Women and Family Development Fund (WFDF), a deposit-taking MFI based on an adapted version of the Grameen model, together with the Lao Women's Union. SBFIC also supports the professional development of a number of large Village Banks close to Vientiane.

With the support of the Rabobank Foundation, the *Association of Asian Confederation of Credit Unions (ACCU)* provides assistance to VFs for their transition to SCUs as well as for the creation of an SCU association.

Initiatives Engaging with the Banking Sector

The *Asian Development Bank* (ADB) has been active mainly at the policy level through its 'Banking Sector Reform Programme' and its 'Rural Finance Sector Development Programme'. The 'Catalysing Microfinance for the Poor' project, running from 2007 to 2012 in collaboration with the Bank of Lao, has substantially contributed to the professionalisation of licensed Microfinance Institutions by developing training modules, coaching and providing matching grants to selected MFIs and through capacity-building in the affiliated FISD. ADB has also invested substantially in developing the Agricultural Promotion Bank into a modern, commercial bank and main provider to rural areas.

The *UNCDF project 'Making Access to Finance more Inclusive for Poor People' (MAFIPP*), running from 2010 to 2017, aims at addressing capacity and infrastructure challenges at macro, meso and micro levels by creating an empowering policy and regulatory environment and improving financial sector infrastructure. MAFIPP has a high profile in the development of digital financial services, and provides support to microfinance institutions through its Fund for Inclusive Finance' (FIF). Within the on-going Making Access Possible (MAP) country strategy for Financial Inclusion initiative, UNCDF provides an in-depth diagnostic of the state of Financial Inclusion, including the first large FinScope consumer survey, as well as information on supply and regulation. The diagnostic represents a basis for the development of a country strategy or road map, and aims at being a pioneer initiative, setting high standards for the future development of the financial sector in regard to Financial Inclusion.

German *Kreditanstalt für Wiederaufbau*'s (KfW) created the EUR 3mio. Lao Access to Finance Fund (LAFF) at the Bank of the Lao PDR (BoL) for on-lending to commercial banks' portfolio expansion in lending to micro, small and medium enterprises, especially in rural areas. So far, one commercial bank (ACLEDA Bank Lao) has gained access to the fund, and two SOBs (Lao Development Bank and Agricultural Promotion Bank) may receive capacity building to match the fund's access criteria.

The *International Finance Corporation (IFC)* under the World Bank Group has several components aiming at strengthening the framework conditions within the financial system. It is supporting the Bank of Lao in improving the National Payment System and its regulatory framework, and in reforming the services of the Credit Bureau. It is also supporting the Ministry of Finance in developing new legislation for leasing and moveable asset lending.

3 POLICY AND REGULATORY FRAMEWORK

3.1 Financial Inclusion Policy

Policy-making in Laos. As mentioned in chapter 1.2, the political wing of the Lao state structure, the Lao Peoples' Revolutionary Party, is responsible for shaping the long-term strategy for socio-economic development of the country. In the period between its five-annual Party Congresses, the Central Committee and the Politburo ensures the implementation of administrative acts. Within the Lao government system, the Ministry of Planning and Investment is responsible for the overall coordination and facilitation of economic growth. The Ministry of Finance has the mandate to oversee the national fiscal policy, and the Bank of Lao is in charge of monetary stability and the development of a sound financial sector. However, none of these agencies is autonomous or has the final decision-making power within their respective fields. High-level decisions have to be agreed upon in interdisciplinary working groups with substantial influence from other line ministries.

Party Congress, Central Committee, Politburo

- Outlines national goals and long-term strategies.

Prime Minister's Office

- Overall oversight over strategy implementation. Prime Minister decrees.

Ministry of Planning and Investment

- Translates national strategy into 5-year National Socio-Economic Development Plans (NSEDP)

Ministry of Finance

- Financial Sector Development Strategy 2008 – 2020.

Bank of Lao

- Rural and Microfinance Strategy 2003.

National Assembly, other ministries and mass organisations

- Influence and participate in decision-taking processes.

Figure 15 – Policy makers for the financial sector

All three institutions are well-respected within the state system, and have considerably strengthened their position. BoL representatives[64] confirm that there is increasing understanding and respect for the achievements of the central bank in maintaining monetary and macroeconomic stability.

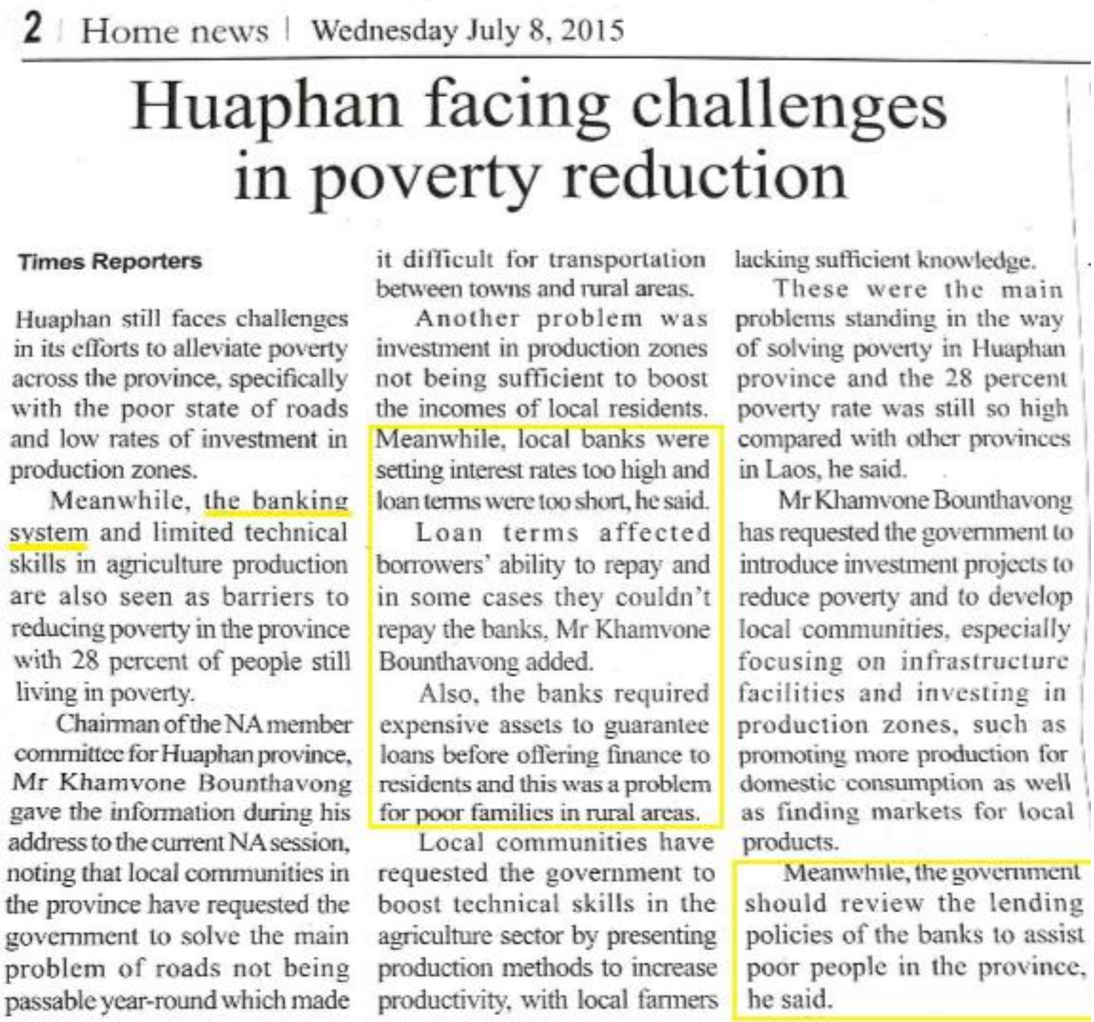
Nonetheless, interference from other powerful actors frequently occurs, in particular from the Prime Minister's Office in its function as the highest-level link between the political and the administrative wings of the government. This situation results in inconsistencies regarding the implementation of national economic and financial policies. Furthermore, state-interventionist directives are common practice, despite the government acknowledging macroeconomic stability as a fundamental requirement for growth and poverty reduction, and the subsequent key role of the private sector in this matter.

Development of a Rural and Microfinance Strategy, and the hand-over of responsibility for Financial Inclusion to BoL's Financial Institutions Supervision Department (FISD). The FIRST project, funded by the Asian Development Bank (ADB), supported the government and the central bank in developing the 'Policy Statement for the Development of Sustainable Rural and Micro Finance Sector' and in subsequently drafting related initial legislation and regulation for the sector. The strategy envisaged the emergence of diverse, regulated and sustainable Microfinance Institutions (MFI). The policy statement was approved in 2003 by the Prime Minister's Office and BoL issued the new microfinance regulations in 2005. The Rural and Micro Finance Committee (RMFC), which drafted the strategy, was chaired by the Financial Institutions Supervision Department (FISD) that subsequently assumed responsibility for the area of Financial Inclusion.

A national economic strategy pointing towards a market-oriented financial sector. The 2003 'National Growth and Poverty Eradication Strategy' (NGPES)[65] represented a benchmark for future government's economic policies. In its conclusions regarding financial sector development, the NGPES set a clear course towards a self-sustaining, market-oriented financial sector by improving the performance of State-Owned Banks (SOB), phasing-out of policy lending and enabling a vibrant Microfinance sector.

However the strategy's implementation was unsuccessful. It proved challenging to implement financial sector development strategies according to the NGPES. State-Owned Banks headed towards commercialisation, but persisted in carrying responsibilities as public service providers. Policy-lending remained significant, as boosted low-interest funds financed by state budget were used as a tool for growth, partly channelled through the Nayoby ('Policy') Bank (NBB) founded in 2007. The language of the current Seventh National Socio-Economic Development Plan (NSEDP)[66] 2011-2015 is much more general and directive, stipulating strengthening management of the financial sector, a sharp increase in national savings as well as in lending to businesses, and in 'providing more opportunities for local people to be able to access the banking system' (p.137). With the NSEDP's eagerness to *'Allocate funds for the realisation of plans and projects using various sources: government investment fund, people's contribution fund, policy banks, village development funds, asset capitalisation, grants and (foreign) loans, financial institutions, international organisations, non-government organisations (NGO), fund-raising from various business entities (both domestic and international), and domestic and foreign investors.'* (p.114), the NGPES' clear vision in the development of a sustainable financial sector seems to have vanished.

Political forces push for low-interest credit. As few Lao government officials are educated in economic and financial issues, the requirements for a sound financial system are generally not well understood within the political system. There is a prevailing perception that poor people need large, unsecured, low-interest credits to escape poverty (see Figure 16). These voices have a strong influence on the government's interventions in the financial sector and its environment.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Huaphan facing challenges in poverty reduction

Times Reporters

Huaphan still faces challenges in its efforts to alleviate poverty across the province, specifically with the poor state of roads and low rates of investment in production zones.

Meanwhile, the banking system and limited technical skills in agriculture production are also seen as barriers to reducing poverty in the province with 28 percent of people still living in poverty.

Chairman of the NA member committee for Huaphan province, Mr Khamvone Bounthavong gave the information during his address to the current NA session, noting that local communities in the province have requested the government to solve the main problem of roads not being passable year-round which made it difficult for transportation between towns and rural areas.

Another problem was investment in production zones not being sufficient to boost the incomes of local residents. Meanwhile, local banks were setting interest rates too high and loan terms were too short, he said.

Loan terms affected borrowers' ability to repay and in some cases they couldn't repay the banks, Mr Khamvone Bounthavong added.

Also, the banks required expensive assets to guarantee loans before offering finance to residents and this was a problem for poor families in rural areas.

Local communities have requested the government to boost technical skills in the agriculture sector by presenting production methods to increase productivity, with local farmers lacking sufficient knowledge.

These were the main problems standing in the way of solving poverty in Huaphan province and the 28 percent poverty rate was still so high compared with other provinces in Laos, he said.

Mr Khamvone Bounthavong has requested the government to introduce investment projects to reduce poverty and to develop local communities, especially focusing on infrastructure facilities and investing in production zones, such as promoting more production for domestic consumption as well as finding markets for local products.

Meanwhile, the government should review the lending policies of the banks to assist poor people in the province, he said.

Figure 16 - Article in Vientiane Times 8/7-2015 - on demands towards the financial system *(Source: Vientiane Times 8/7/2015)*

A policy focus on rural areas with a division into two de facto financial subsystems. With the high percentage of poor people living in rural areas, the government focussed its poverty alleviation efforts towards rural areas, and in particular towards the poorest districts identified in the NGPES.

Following the examples of Thailand and Vietnam, the government channelled large amounts of subsidised loans into these priority areas. Inspired by the Vietnamese model of the Vietnam Bank for Social Policies (VBSP), the Nayoby Bank was created with the mandate to disburse its credits to poor farmers and to key value chain players.

Inspired by the Thai '1-mio. Baht Funds', the Poverty Reduction Fund, administered by the National Committee for Rural Development and Poverty Eradication (NCRDPE), which operates at the department level within the Prime Minister's Office, initiated credit-based 'Village Development Funds', capitalised by government funds. Large-scale agricultural programmes, such as the 'Northern Uplands Livestock Program'[67] also engaged in disbursing large amounts of low-interest, project-specific credit. Several development projects are also promoting grant-financed village funds with low interest rates.

This policy has led to the *de facto* division of the country into two main regions with two distinct financial systems. The rather wealthy and well-developed lowland areas have good access to commercial credit and show high levels of economic activity, active informal and semi-formal markets and feature high interest rate levels. On the other hand, government priority areas, which mainly consist of mountainous and rural areas, see their main source for credit in publicly funded credit schemes. Interest rates in informal markets are lower than in high-potential markets due to the low demand for commercial credit. These areas also show little commercial finance. Expanding into a low-density, low-income and high-cost environment is challenging, and the competition from government-subsidised schemes and their impact on peoples' expectations and behaviour are disincentives for commercial institutions to enter this market.

3.2 Regulatory Framework

Financial Sector Regulation

Financial sector regulators and regulations. The Ministry of Finance (MoF) remains the financial system regulator, while sector regulation and supervision has been transferred to the Bank of Lao. The ownership of all state-owned enterprises, including the SOBs and joint venture state banks, remains with the Ministry, as well as the regulation and supervision of the commercial insurance sector. Public health insurance and social security is under the responsibility of the Ministry of Labour and Social Welfare.

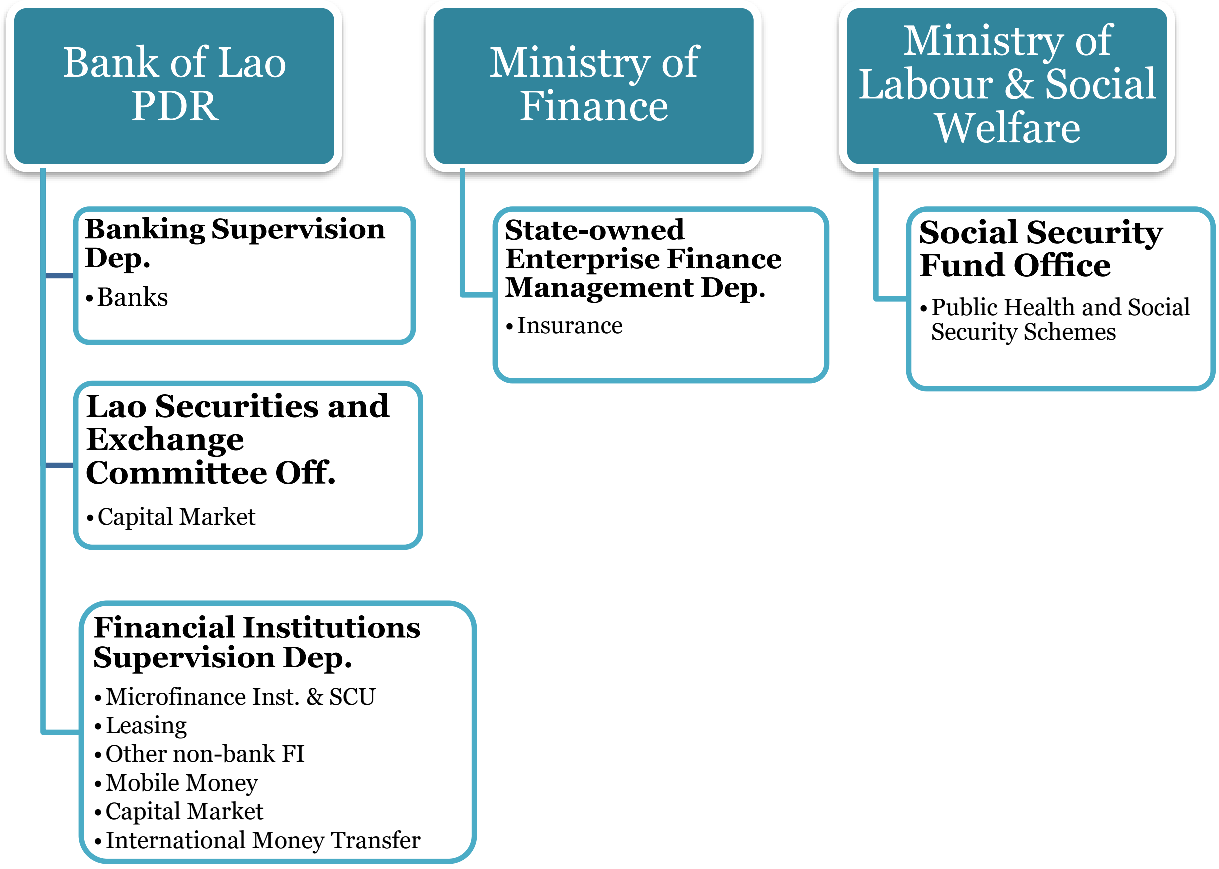


Figure 17 –Financial sector regulators

A legal framework developed by BoL. The 1990 Central Bank Law, later amended to its present version, the 'Law on the Bank of the Lao PDR'[68], outlines the structure of the financial system. The Bank of Lao is responsible to regulate, '*administer and supervise the operations of commercial banks and financial institutions under its supervision to ensure the stability and the development of the banking system and financial institutions*' (art. 5.1). Since then, the Bank of Lao has developed the financial sector's legal framework through laws, decrees, regulations, circulars, guidelines and instructions.

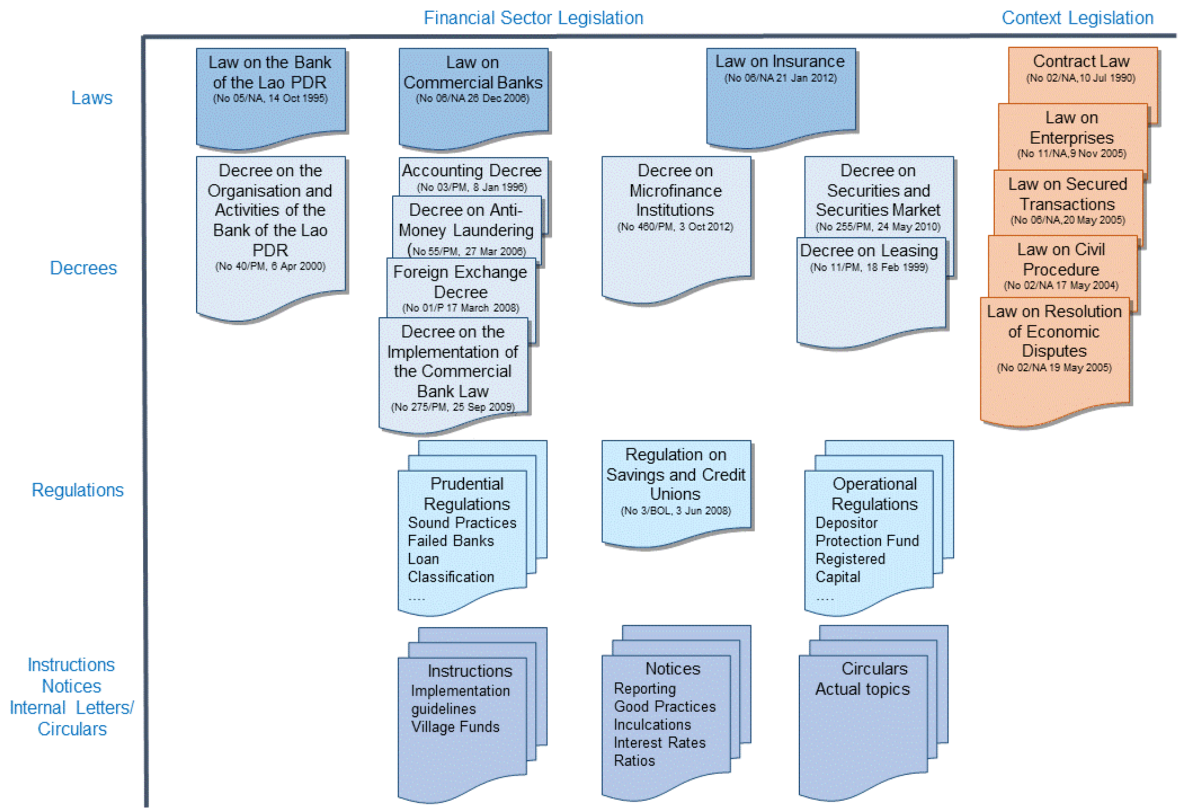


Figure 18 - Mapping of financial sector regulation in Lao PDR *(only main documents)*

Regulations and markets need to develop in parallel. According to Flaming (2010), *'the existing framework of policies, regulation and supervision establishes a sound foundation for an inclusive financial system in Laos'* (p.1). It allows for the development of a diversity of financial institutions offering financial products to poor people. Fleming also states that, although a sound and enabling framework has been adopted, it has been established before service providers have developed sustainable business models. Adjustments will therefore be necessary between regulation and market practices. Accordingly, law and decree texts use general wording, and more detailed provisions are subsequently outlined in lower level documents that can be subject to periodic revision.

Common interim legislation through low-level legal documents. As previously mentioned (ch.1.2 Historical & Political Context), political decision-making processes can be very lengthy. The interdependence of legislation and sector development may be another reason for legislators to slow down the elaboration of laws or implementation guidelines. Some of the sector-related regulations – legislation for a National Payment System and digital finance, a revision of the leasing law and guidelines for the Microfinance Decree, among others– are currently under elaboration, and, in some cases, have been so for a long period. As the market changes rapidly and continuously, identifying references to inform legislation is challenging. Therefore, legislators govern on an interim basis, filling the gaps of missing regulation by issuing case-to-case decisions, lower level circulars, instructions and notices.

Although meant for increasing legislation's flexibility, this practice makes it difficult for the financial sector as well as for the supervisor to keep track of the legal framework.

Regulation of the Banking Sector

Banks can operate independently. They are entitled to carry out a range of banking and financial operations. The Law on Commercial Banks[69] establishes the right of banks to do business as independent commercial units, by obeying prudential regulations and sound practices[70] promoted by the central bank. Besides core banking operations – deposits, credit, payment and foreign currency exchange – banks are also entitled to undertake financial operations, including the issuing, buying and selling debt securities; money broking; insurance; leasing; services as an investment portfolio manager; underwriting and distributing debt and equity securities and dealing in equity securities. The law also establishes compulsory transparency procedures for banks by requiring them to publish their audited financial statements and annual reports within four months after end of the financial year.

Regulations are not restrictive, but branch expansion and interest rates are regulated. The law distinguishes between 'affiliates, branches and representative offices'. Opening branches requires additional registered capital, 3 years of profitability operations and the prior approval by BoL. This restricts any newly licensed institution to function with a single branch, for 3 years at least before expanding, and service units, which are 'at the bank's own discretion. Service units are restricted in their scope of operations to 'deposit and withdrawal of savings, money transfer, foreign currency exchange and other operations as assigned by the branch'[71]. This formulation leaves grey areas for workarounds[72]. Banks can use agents to extend their banking services; in practice agents are mainly used for international money transfer services. BCEL's pilot project on mobile money for example involves the use of local agents.

There is no ceiling for the absolute interest rate on credit. Instead, there is a ceiling on the interest spread between savings and credit, currently set at 4% between savings and credit products of the same maturity[73]. However, the central bank does not provide clear provisions on how to calculate this spread. For instance, there is no long-term deposit benchmark rate to evaluate a ceiling rate on long-term credit (>3 years). Flat interest rates are authorized for personal loans of any size and business loans up to LAK 15 mio. [74]. The effective interest rate doubles in the case of a 1-year loan term, which exceeds the authorized spread. This restriction could have negative effects on banks downscaling, as providing services to remote and low-end customers typically incurs higher costs.

The Bank of Lao recently issued ceilings on interest rates for savings in the national currency[75]. Officially, the central bank justifies its decision to lower interest rates[76] by the current low inflation rate. Banks reacted swiftly in adjusting their deposit interest rates, while credit interest remains unchanged until further notice. This decision reflects the Lao government's lack of familiarity with the concept of competition.

The central bank imposes an upper target for Non-Performing Loans (NPL) of 3% on banks[77].

Regulation of the Microfinance Sector

The legal framework for specialised Microfinance Institutions has evolved within the past decade. Following the first 2005 Microfinance Regulations and their significantly revised 2008 version, the Microfinance Decree[78] was adopted in

2012. The decree distinguishes between Deposit Taking MFIs (DTMFI), Non-deposit Taking MFIs (NDTMFI) and Microfinance Projects. Deposit Taking MFIs are entitled to take deposits from customers, while Non-deposit Taking MFIs are restricted to taking voluntary deposits from their members, up to a maximum amount of LAK 200 mio. Savings & Credit Unions (SCU) are not considered as Microfinance Institutions and are under separate regulation[79].

In many regards, Microfinance Institutions face more restrictive regulation than banks (see Table 14). Microfinance institutions (MFI) are under the special scrutiny of the central bank, probably due to political concerns over potential exploitation of poor customers. MFIs' scope of permitted business activities is limited to core banking services of savings and credit - only SCUs are permitted to offer domestic payment services. The size of loans to clients is limited in absolute terms for MFIs, and in relative terms for SCUs. Financial sector regulation does not provide common standards for loan provisioning, including regarding terms and conditions of loans and overdue ageing, applicable to all financial service providers across categories. MFIs and SCUs have to comply with more restrictive financial ratios than banks. MFIs have to apply stricter loan categorisation and slightly higher rates for loan loss provision: for MFIs, the categorisation of overdue loans into Substandard, Doubtful and Loss, follows the schedule of respectively 30, 90 and 180 days past due date. For banks, the schedule is 90, 180 and 360 days past due date. For SCUs, restructuring of overdue loans in order to avoid NPL classification is prohibited.

Village funds create unfair competition for MFIs. A number of MFIs reported encountering unfair competition from village funds. Village funds are presently not subject to prudential regulation, which implementation represents an additional cost to MFIs. Moreover, village funds can offer loans under more flexible conditions and benefit from higher returns on savings deposits than registered MFIs, due to their extensive use of low-skilled volunteers, their low operational costs and lack of sound accounting and loan loss provisioning practices. Village Funds enjoy a senior creditor status over MFIs towards village authorities, which are the first instance arbitrates for over-indebtedness cases. Because of their high dividends, many village funds experience large savings influxes. The latest microfinance survey[80] reports 23 village funds with deposits exceeding LAK 1 bio; however, the survey only includes complete data for half of registered village funds. An unknown number of village funds are estimated to have similar sizes to some of the largest MFIs[81] i.e. around 81 bn. in assets. Customers show lack of awareness on the potential risks linked to using village funds for their savings.

Table 14 – Core Elements of financial institutions regulation[82]

	SCU	Microfinance Projects	NDTMFI	DTMFI	Leasing companies	Commercial bank	Insurance companies
Ownership structure	Members' shares	Development organisation	Shareholders	Shareholders	Shareholders	Shareholders	Acc. to Law on Investment Promotion and Law on Enterprise
Requirement for registered capital	LAK 30 mio.	*LAK 1bio., project funding to be transferred in full*	*LAK 200 mio.*	*LAK 3 bio.*	*LAK 500 mio.*	*LAK 300 bio. (Foreign commercial bank branch only LAK 100 bio.)*	*LAK 16 bio.*
Permitted business operations	*LAK only: Credit and savings to members only, domestic payments, insurance broker*	*Not specified*	*LAK only: Voluntary savings up to 80% of reg. cap., credit*	*LAK only: Public savings, credit, domestic payments, insurance broker, investment into other business up to 10%, upon application to BoL*	*Leasing*	*Public savings, credit, payments, insurance, financial business*	
Max. share fixed/registered capital at registration	*0%*		*15%*	*10%*		*25%*	
Capital requirement for new branch				1bio.	*At least 20% of total capital or as requested by BOL* Shall have profit for at least 2 consecutive years of operation	*LAK 100 bio.* *Shall have profit for at least 3 consecutive years of operation*	
Foreign investment	*Only debt and grant*	*Intrinsic*	Max. 30% of capital and upon BoL approval, foreign borrowing permitted upon BoL approval	Max. 30% of capital upon BoL approval, foreign credit permitted upon BoL approval	*No limitation*	*Allowed*	

	SCU	Microfinance Projects	NDTMFI	DTMFI	Leasing companies	Commercial bank	Insurance companies
Financial ratios							
Cash/total deposit	*4%*			*4%* [c)]		*2%* [a)]	
Capital adequacy Ratio	*12%*			*12%* [c)]		*8%*[a)]	
Loan/deposit ratio						*No limitation*	
Liquidity ratio (cash+deposit /debts)	*20%*			*20%* [c)]			
Loan Classification	*Substandard after 30d/25% Doubtful after 90d/50% Loss after 180d/100% Restructuring to avoid NPL classification prohibited*		*Substandard after 30d/25% Doubtful after 90d/50% Loss after 180d/100%*	Substandard after 30d/25% Doubtful after 90d/50% Loss after 180d/100%		*Substandard after 90d/20% Doubtful after 180d/50% Loss after 360d/100% Restructured loans are not NPL* [b)]	
NPL limit	*5%*		*5%*	*5%*		*3%*	
Cap on interest rate spread	*none*	*Not clear*	*Not clear*	Not exceeding bank interest by more than 3%		*4%* [e)]	
Upper limit for loan size	*10% of share capital*			LAK 50 mio.; 80% of portfolio must be loans <LAK 50mio., not less than 10% to female clients		*Lending to each individual<25% of its capital; group of individual<50% of its capital; Large customer<8 times of its capital.*	
Calculation of credit interest	*n/a*	*n/a*	*n/a*	Declining balance for loans >LAK 5mio. [c)]		*Declining balance, flat rate for 1 year term of commercial loans <LAK15mio. and for private*	

	SCU	Microfinance Projects	NDTMFI	DTMFI	Leasing companies	Commercial bank	Insurance companies
						consumption loans f)	
Mandatory deposit of reg capital at BoL/MoF	*0% and shall be member of DPF*		*10%*	*25% (0%, if member of Depositors' Protection Fund)*	*10%*	*25%*	*33% of each type*

Sources: if not stated particularly, Regulation for Savings and Credit Unions, No 3/BOL, 3 Jun 2008 for SCU, Microfinance Decree No 460/PM, 3 Oct 2012 for MFI and microfinance projects, Decree on Leasing, No 11/PM, 18 Feb 1999 for leasing companies, Law on Commercial Banks No 6/NA, 26 Dec 2006 and Decree on the Implementation of Commercial Banks, No 275/PO, 25 Sep 2009 for banks and Law on Insurance, No 6/NA, 21 Jan 2012 for insurance companies

a) *Agreement on cash reserves ratio of commercial banks, No. 761/BOL, 3 Sep 2013*
b) *Loan Classification Regulation, No 6/BOL, 11 Maj 2004*
c) *Implementation guidelines of Decree on Microfinance Institutions, No 1/BOL, 19 Apr 2016*
d) *Agreement No. 529/BOL, 21 July 2015*
e) *Agreement No. 330/BOL, 02 July 2007*
f) *Agreement No. 361/BOL, 23 Apr 2012*

Regulations have unintended, negative effects on MFIs' growth and expansion beyond the financial frontier. Though not directly specified in the legal framework, the Financial Institution Supervision Department (FISD) has been promoting a strict categorisation of microfinance institutions as a tool for their gradual growth. For a number of years, FISD has organised information meetings throughout the country to promote the upgrading of village funds into Savings and Credit Unions, of SCUs into MFIs and of non-deposit taking MFIs into deposit-taking ones. Although increasing the level of regulation with the size and scope of operations of an institution is coherent, the strict categorisation subsequently poses substantial challenges to financial institutions that are planning to expand beyond the limitations of their license. Indeed, financial institutions experience a double burden due to their current licence restricting their expansion on the one hand, and meeting serious obstacles to transition to the next category on the other. Thus, no cases of upgrade from NDTMFI to DTMFI were recorded and all DTMFI licenses were received first hand.

Village funds and SCUs are membership-based. Their structure cannot easily be transformed into the investor-based shareholder system of MFIs. Capital requirement for MFIs to enter the market may seem low, but they are relatively high for initiatives based on a broad membership compared to village funds and SCUs, which rely on investments of a few wealthy individuals.

Non-deposit taking MFIs that are based on member or client savings and shares are limited by the imposed maximum of LAK 200 mio. in voluntary savings mobilisation, while simultaneously encountering difficulties in raising the LAK 3 bio. capital requirement for registering as a Deposit-taking MFI. Even though the central bank has issued a 1-year grace period for Non-deposit taking MFI, and a 4-year period for Deposit-taking MFIs[83], such growth can be difficult to achieve solely from own resources.

MFIs' potential for expansion is undermined by restrictive legislation. Although MFIs have to operate under more restrictive conditions than banks, interviews with MFI representatives highlighted that strict regulations enforcing good practices were perceived as a positive factor in achieving good results. However, representatives of growth-oriented MFIs underlined existing barriers to expansion, some of which related to regulation.

MFIs face challenges to expand geographically. In order to establish a new branch, an MFI is required to pledge additional capital, presently LAK 1 bio.; the MFI circumvent this rule by opening service points instead of branches, as they do not carry the same requirements. However, expansion into new provinces requires the mandatory opening of a branch[84].

In contrast to other financial institutions, foreign investment into MFIs is limited to 30% of the MFI capital, which prevents rapid scaling-up through the support of an international fund or organisation.

Village Funds regulation

BoL is responsible for village funds regulation. Two Prime Minister Instructions[85] stipulate that the Bank of Lao should be responsible for the coordination, regulation and policy formulation of the financial sector, in view of ensuring access to sustainable finance under appropriate conditions. The 2007 instruction specifically concerns 'village funds, savings and credit unions and microfinance institutions'.

The legal status of village funds remains unclear within the 2012 MF decree. The decree stipulates that 'Microfinance projects' are required to register at the Bank of Lao; this includes village development funds, village banks or similar projects undertaking business operations similar to micro finance established by a group of people, entities that have organisations or individuals providing funding'. However, to date no village fund or microfinance project has undertaken the registration process.

Prime Minister Instructions impose unrealistic requirements to the BoL. Flaming states that '*these organizations, the Village Development Funds (VDFs), lack the resources and capacity to comply with basic reporting requirements or basic performance standards, and this makes them very difficult, if not impossible, to regulate and supervise effectively. This area requires a more fundamental policy decision between different options for regulating the sector.*' [86] The large number of village funds as well as their autonomy and informality hinders their individual supervision by the BoL.

As a result, the BoL met these responsibilities with reluctance, as it is aware of its limited capacity to supervise thousands of such small-scale institutions.

Informal finance is prohibited, but tolerated in practice. According to the law, all individuals, organisations and entities undertaking microfinance operation must apply for a license at the BoL[87]. However, as demonstrated in the financial sector overview (See chapter 2.5), a multitude of informal providers are active, in particular in lending and leasing activities. There are no registered cases of prosecution of unlicensed providers by BoL.

Regulation of the Insurance and Payment Sector

The Ministry of Finance is the main authority for the insurance sector. Regulation and supervision of the insurance sector has remained under the responsibility of the Ministry of Finance's State-owned Enterprise Finance Management Department, while the licensing process is under the responsibility of the Ministry of Planning and Investment. The original 1990 law regulating the insurance sector has recently been revised. It broadened the range of insurances, which are currently categorised into life and non-life insurance. A number of types of insurance are compulsory[88], the most prominent of which being vehicle insurance. Opportunities for foreign investment are emphasised, including joint ventures between international companies and domestic insurance companies or brokers.

Legislation of the new National Payment System (NPS) is currently under elaboration. Currently, payment services and mechanisms are regulated by low-level legislative documents. The initial draft of the new NPS legal framework is completed, however further drafting is required to ensure its compliance with ASEAN standards.

International money transfer operators are not regulated by the BoL. However agents appointed by international money transfer operators are required to obtain a license from the BoL. Agents appointed by international money transfer operators include banks, Lao Post, non-bank financial institutions and individuals. Banks primarily offer remittance services through their branches, while some opt for non-bank sub-agents.

Digital financial services remain unregulated. BoL is currently issuing trial licenses for upcoming digital financial service providers, which will be the basis of the learning process on digital finance and is likely to inform future regulation.

Cross-cutting Regulations

No barriers to the formal financial sector from Anti-Money Laundering (AML) regulations. Unlike other countries, Lao anti-money laundering regulations[89] do not create factual entry barriers for poor people to enter the formal financial sector. Customer due diligence is required for the establishment of business relations – including the opening of an account -, for transactions beyond a certain volume and for suspicious transactions. Customer due diligence includes the provision of verified identification using reliable and independent source documents, data or information. Virtually every person legally residing in Laos fulfils the identification requirements to open a bank account, either with their family registration booklet, a national ID card or an international passport[90]. Some banks additionally require working permits, reference letters or other documentation, but this practice is not related to legal requirements[91].

AML implementation is weak. Laos' international reputation on Anti-Money Laundering suffers from its poor practices on the matter. Weak implementation of AML instruments may have attracted a number of doubtful investors to Laos, while undermining its potential to attract foreign investments from companies with high AML standards.

Current financial collateral regulations allow banks to grant loans unrestrictedly. Previously, the central bank would set limits to the proportion of loan granting in accordance with types of collateral pledged[92]. The highest limit was set at <90% of collateral for jewellery, Lao Government bond and deposit; <60% for land title pledge; and <30% for consensus agreements. However, four months after the issuance of this regulation, the BoL announced a new regulation on collateral[93], allowing banks to grant credit at their own discretion and cancelling the set of limitation. The range of pledgeable items is limited to mainly land titles and liquidity assets such as jewellery and bank deposit. The IFC is currently working with MoF on a legal framework for moveable asset lending.

Absence of legal customer protection for financial products. No legal measures have been adopted to protect clients from bad practices in the financial sector. Compared to other countries, financial institutions in Laos have a low-profile marketing strategy and exploitative practices are rare. However, the increasing use of flat rate[94] interest products has raised concerns, as few clients are able to distinguish between nominal and effective interest rates. Banks are permitted to set their own regulations for the handling of dormant accounts and for transferring outstanding balances to their own profit and loss account, which can provide an incentive for deviating from common international practice of transferring them to the central bank for long-term custody.

Even though Deposit-taking MFIs and SCUs are required to be members of the Depositors' Protection Fund (DPF), in practice the DPF does not accept applications from non-bank institutions.

3.3 Supervision

Financial institutions are under the supervision of three institutions. Banks are supervised by the Banking Supervision Department of BoL. Non-bank financial institutions, including pawnshops, leasing companies, microfinance institutions and Savings and Credit Unions, are under the supervision of the Financial Institution Supervision Department of BoL. Both the Banking Supervision and the Financial Institution Departments are organs of the Bank of Lao. Supervision of insurance companies remains under the Ministry of Finance's State-owned Enterprise Finance Management Department.

Limited supervision capacity. It is generally acknowledged that the Bank of Lao's supervision capacity is limited, particularly in terms of staff capability and experience caused by the generally low level of education and the high staff post rotations within the government system.

Poor reporting by financial institutions. Despite financial institutions being required to submit their financial reports to FISD on regular basis and in accordance with reporting templates issued by BoL[95], central bank regularly faces discrepancies between reported and actual data. Data and reports submitted by financial institutions are often incomplete and incorrect. A number of institutions fail to meet reporting schedules or bypass reporting. Reported data from DTMFIs, NDTMFIs and SCUs is transmitted per email in Excel format and is consolidated into a FINA database of FISD on monthly basis, while data from leasing companies and pawnshops are consolidated separately in Excel format. Not all financial institutions can afford Management information system (MIS) software such as MicroBanker, therefore making the standardised consolidation of data challenging and time-consuming.

Commercial banks reporting requirements. Commercial banks are required to submit their transaction data through BoL's MIS database - called Bank 2000- on a daily, monthly, quarterly and yearly basis. Daily data is to be uploaded before 9am of the following day while the remaining reporting schedules shall be submitted within seven working days[96]. Besides reporting to the BoL, commercial banks are also subject to public reporting requirements, by making their financial reports available on their websites on quarterly and yearly basis.

Low levels of transparency. Despite the legal requirement for banks to publish their financial statements on their own websites, in practice banks' compliance varies. For private banks, only part of foreign bank branches meet reporting requirements, while among State-Owned Banks, only BCEL complies with reporting. The MAP research process confirmed the difficulties to mobilise even basic data on the financial system in Laos, in particular for the banking sector. Data from MFIs, although presenting a certain error margin, are published quarterly on the BoL website.

BoL follows a practical approach towards supervision and compliance. The banks and MFIs interviewed for this study unanimously stated that regulations were not difficult to comply with, and that there was a good working relationship between financial institutions and the BoL. Even though regulations are not always best fitted to the conditions of a fast developing sector, interviewees perceived that the BoL had a practical approach to regulations, and that dialogue was satisfactory between the sector's associations - the Bankers' Association and the Microfinance Association - and the BoL. Thus, BoL urges Savings and Credit Unions and leasing companies to form similar sector organisations.

Violations of regulations rarely result in sanctions or penalties. Even though BoL has lawful penalties for violators of its regulations[97], including monetary penalties, removal of responsible persons and temporary or permanent revocation of the financial institution's license, their enforcement is lagging behind. The Bank of Lao approaches its task to empower and strengthen financial institutions through advice and dialogue rather than punitive measures. In most cases this approach allows to tackle the above-mentioned inconsistencies between regulations and practical requirements. On the other hand, it also undermines the Bank's authority as a regulator and supervisor of the financial sector. Non-compliant institutions continue their activities without encountering sanctions from the BoL.

The supervision of village funds remains unclear. Overall responsibility for the regulation and supervision of village funds is, according to Prime Minister Instruction, under the Bank of Lao. In parallel, the government established village development fund supervision committees (VDFSCs) at the central, provincial and district levels; however, their functionality remains unclear. In practice, Rural Development and Poverty Eradication Offices (in rural areas) and Lao Women's Union (in city areas) share the supervision of village funds, but not in a standardised way. Coordination with the BoL via its provincial branches does not happen systematically. BoL is only actively involved in village funds through its Southern Branch in Champasak, following an intervention of the provincial governor.

4 TARGET MARKET ANALYSIS

This chapter provides information on Financial Inclusion from the demand side perspective. Chapter 4.1 highlights relevant contextual factors that influence the present use of financial services in Laos, which are important to better understand the nature of demand and to assess potential future demand patterns. These factors include cultural habits, the rural syndrome of remoteness as well as an assessment of clients' capability to use financial services for their own best benefit.

Chapters 4.2 and 4.3 present and interpret the results of the first financial survey carried out in Laos: FinScope 2014 (see Box 1).

Box 1 - FinScope - A financial consumer survey

FinScope surveys are nationally representative surveys of consumers about the way they source their income and manage their financial lives.

The main objective of FinScope is to measure and profile the levels of access to financial services by the adults in a particular country, across income ranges and other demographics, and making this information available for use by key stakeholders such as policy-makers, regulators, and financial service providers.

The provided information aims at improving the understanding of the adult population in terms of the following:

- Livelihoods and how they generate their income;
- Their financial needs and/or demands;
- Their financial perceptions, attitudes, and behaviours;
- Their demographic and geographic distribution;
- The obstacles they face and the factors that would have an influence on their financial situations;
- Current levels of access to, and utilisation of, financial services and products (formal and/or informal);
- The landscape of access (i.e. types of products used in terms of transactions, savings, credit, insurance and remittances);
- Drivers of financial products and service utilisation;
- Barriers to utilisation of, and access to, financial products and services;
- The size of the market; and
- The commonalities and differences between different market segments

FinScope surveys look at the use of financial services from formal as well as from informal providers. They identify the factors that both impede and facilitate effective access to financial services. Surveys also encompass attitudes, behaviour and quality-of-life factors. In each country the questionnaire and survey process is tailored to incorporate local conditions and reflect local interests.

FinScope is an initiative of FinMark Trust – since 2002, FinScope surveys have been conducted in presently 22 countries in Africa and Asia.

In Laos, the FinScope survey sample included 2040 individual interviews that were conducted by the Lao Statistics Bureau between November 2014 and January 2015.

As the results of the most recent population census in 2015 were not yet available, FinScope was calibrated to the previous census and village listing in 2005.

Chapter 4.2 describes the overall take-up of financial services by FinScope respondents and in regard to demographic and economic factors. Chapter 4.3 elaborates on the actual usage of financial services by identified target groups. The Product Market Analysis in chapter 5 further specifies the take-up of the four products in regard to criteria including locality, gender, age, education and level of income as well as throughout the target groups[98].

4.1 Target Market Context

Cultural habits in regard to finance

Laotian culture has traditionally been debt-averse. Culture and tradition have a strong influence on Laotians' economic behaviour (See chapter 1), including their use of financial services. Many Lao people still take pride in sustaining a simple livelihood without reliance on others, e.g. by getting indebted[99]. Hence we observe a high propensity among Lao adults to satisfy financial needs by an accumulation of funds for later use rather than by ex post debt financing. 65% of adults stated that 'it was embarrassing to borrow money or to buy on credit'.

Laotians rely on informal arrangements with their kin for economic emergencies. However, whenever immediate needs cannot be satisfied by the means of the household, people can, to a wide extent, expect the support of their kinship networks as well as of the community of their village. Extended family and friends will usually be the first to be approached when a person has need for a credit; 83% of adults could get money from the community when in need, and 93% from the family. Loans between family members are interest free and based on soft terms. The borrowed amounts are mainly small. The receiver will repay, when and if he can: part of these loans is never repaid, which highlights the traditional conception of loans as favours rather than obligations to repay.

Written contracts with fixed conditions are not rooted within the Lao tradition. Contracts do not have the same binding effect as in modern societies. Agreements, oral or in writing, are usually open for renegotiation according to the present situation. Today, this factor remains a principal reason for many Laotians' preference to borrow within a familiar, informal context. It also provides insight into many financial institutions' struggle to make their customers adhere to their contractual obligations.

Risk aversion is intrinsic to a culture rooted in farming. Risk aversion is another prevalent feature of Lao culture. Under the conditions of a highly insecure environment that has been shaping peoples' livelihoods, for many families, one failed activity can mean a shift from poverty to misery. Farming households regularly see their annual crops reduced to nothing by drought or flooding, and their wealth destroyed when endemic diseases wipe out their livestock. Major strategies to deal with uncertainty are income diversification, low-input investment and debt aversion.

Cultural attitude towards debt is changing, partly due to strong government promotion. On the other hand, Laos is experiencing on-going substantial change of attitudes in large parts of the society. In urban centres, especially in Vientiane, credit has become an integral part of a recent development towards a consumerist behaviour. The government actively promotes credit at the country level as a mean towards economic progress, and this not always with an appropriate critical assessment of credit use or benefit. Many government officials with little understanding of poor people in risky conditions' rationale perceive farmers who are reluctant to take credit as backwards.

The elite is overrepresented amongst loan defaulters. Elements of feudal patrimonialism originating from the ancient lowland culture are still prevailing, including an intrinsic acceptance of the elite to exploit their opportunities beyond the moral framework applying to commoners[100]. Up to today there remains a strong tendency towards elite capture and towards wealthy and powerful individuals being heavily overrepresented amongst loan defaulters[101].

Level of remoteness

Many people have large distances to travel in order to access formal financial services. Geographic remoteness itself constitutes a factor limiting access to formal services, including financial services. 42% of adults living in rural areas with road access, and 56% having no road access, have more than 1 hour's travel to the nearest bank branch. There are still a number of districts that do not have formal financial institution outlets besides the post office, which is limited to money transfers.

Table 15 - FinScope: Proximity to Service Infrastructure

		Adults using or aware of destination	Take 60 minutes or less			
			Total	Urban	Rural with road	Rural without road
1	Grocery Store	99%	97%	99%	96%	95%
2	Market	99%	74%	95%	63%	46%
3	Public transport/ Bus Stop	96%	78%	95%	70%	62%
4	Bank branch	95%	71%	94%	58%	44%
5	ATM machine	92%	68%	91%	56%	45%
6	Postal office	91%	68%	90%	56%	45%

However distance is not the primary reason for low use of financial services in remote areas. The effect of remoteness on financial inclusion should not be overestimated. Only 13% of persons not using formal sector institutions identified distance as an obstacle. For instance, rural areas are only slightly underrepresented regarding the use of formal institutions for remittance sending or receiving, (**Error! Reference source not found.**) compared to the overall population distribution (**Error! Reference source not found.**). This fact leads to the hypothesis that rural dwellers use formal financial services, regardless the distance from their residence, if the services are considered relevant.

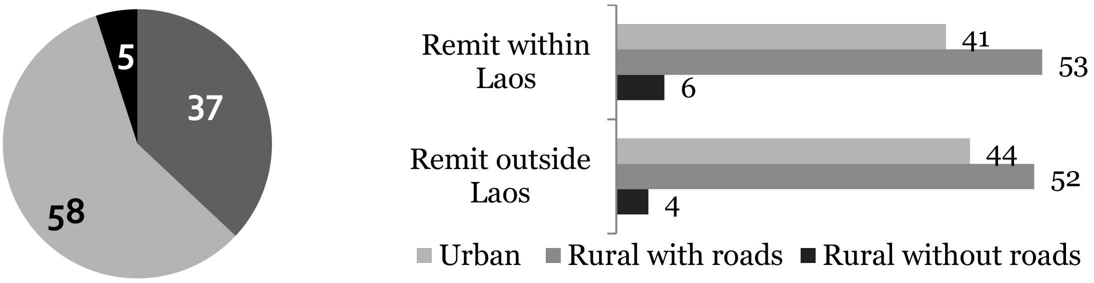


Figure 19- FinScope: demographic distribution amongst users of remittance services in regard to their location

Indeed, there is little use for cash in remote villages, as there are few opportunities to earn or spend money in the village itself. Most expenses are made when travelling to the nearest town's shops, market, hospital or entertainment venues. The use of financial services is mostly associated with trade and purchases at market places or use of other services like health services. Thus, distance is often not felt as a major impediment. Nevertheless, for some financial needs, liquidity – ready access – is key, particularly in the event of emergencies, in which case proximity plays a central role.

Remoteness is a composite factor that limits demand for financial services. The negative correlation between geographical remoteness and use of financial services is thus a secondary one. It is not the distance to the financial service provider per se that limit the demand for and use of financial services, but rather the combined effects of remoteness on market connection, education, self-confidence, among others. The extension of formal financial institutions' outlets to remote areas alone is therefore likely to have a limited effect on the use of services.

Financial capability

Most Laotians' exposure to a cash-based economy is relatively recent. Just one decade ago, most of the villages in mountainous areas lacked road connection. Only a small share of their economy was monetised. In recent years, these villages have been connected to more efficient markets. An increasing share of income now derives from cash crops, sale of livestock or labour. For large parts of the Lao population - rural or urban - it is a relatively recent experience to dispose of financial means beyond most urgent necessities.

Living in subsistence societies with sale or bartering of the limited surplus production, these people are highly skilled in surviving on very small budgets. Money was mainly used for urgent household necessities and emergency situations. An increasing part of their income being earned from special cash crops, livestock or hiring out labour, they now experience the use of money as a mean of further assets accumulation by either savings or investments into income-generating activities, which are new to most of them.

Many adults are virtually innumerate. Given the high level of illiteracy and the low quality of education, many Laotians, especially adults, are virtually innumerate. A recent survey on financial literacy[102] revealed that even the most basic mathematical skills cannot be presumed. 41% of the respondents were unable to complete simple addition of LAK 30.000 payments for 12 consecutive months. 45% could not identify the right combination of bank notes representing the value of LAK 89,000 within 30 seconds. Only 37% of respondents were able to calculate 2% of LAK 1 million.

There is a strong correlation between the level of completed formal education and the numerical skills of a person, with adult women in general showing lower levels of formal education and financial literacy. The likeliness to respond correctly raised sharply with the level of education. However, it is striking that even after 11 years of schooling, 28% of respondents having completed secondary school, gave a wrong answer.

There is a gap in financial proficiency between women and men from ethnic minorities. In contrast, ethnic lowland women did not lag behind men regarding financial and business skills.

Lack of information on financial products. Most people have a general understanding of the way banks and other formal financial institutions operate; however the lack of specific knowledge on products and how to obtain them may deter many from using them. 68% of adults stated a need for more knowledge about financial issues including more information on financial products as well as how to use them (Figure 20).

> 'The skills problem in Lao PDR is deeper and more severe than is generally recognized, being a problem not simply of vocational skills but of even basic reading and numeracy skills.' (WB Lao Development Report 2014)

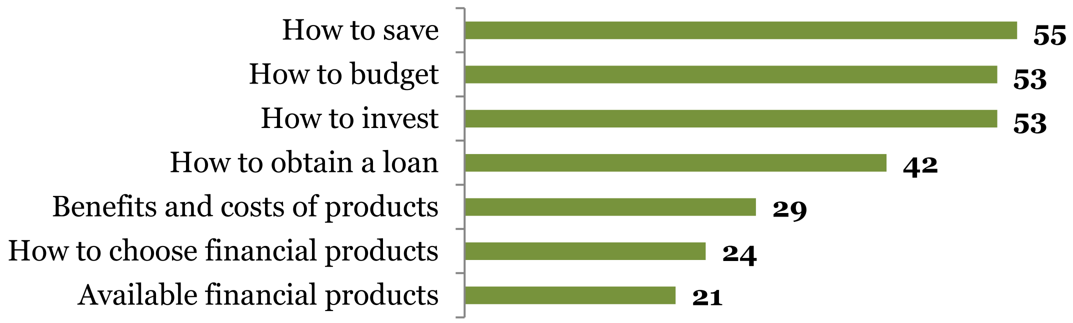


Figure 20 - Desired financial information

As businesses increase in scope, basic budgeting and planning skills as well as knowledge of basic management and accounting practices are lagging behind. For instance, only 33% of business owners were keeping records.

4.2 Take-up of Financial Services

Overall Access Strand

Roughly half of the adult population (47%) uses at least one product from a formal financial service provider, with services from banks used by 36%. 28% of adults who did not use formal financial institutions were serviced by financial institutions that are not under the supervision authority of the central bank. One out of four adult Laotians was not using any financial service at the time of the survey.

Figure 21 - Overall access strand

Box 2 - The Access Strand explained

Breaking down the Access Strand. The Financial Access Strand is used to enable comparison of levels of financial inclusion across countries or market segments. In calculating the access strand, a hierarchical approach is used in order to depict:

- Banked: The percentage of adults that has bank products. This is not necessarily exclusive usage – these individuals could also be using financial products from other formal financial institutions or informal products.
- Other formal: The percentage of adults that has financial products from non-bank formal financial institutions such as microfinance institutions (MFI), the Lao Postal Services or insurance companies. These individuals could also be using informal products.

The banked and other formal segments together form the formally included population.

- Informal: The percentage of adults that is not formally served, but use informal financial products or mechanisms. This is exclusive informal usage and does not include individuals who are within the banked or other formal categories of the access strand that also use informal services.
- Excluded: The percentage of adults that are presently not using any financial products – formal or informal – to manage their finances.

The access strand does not show overlaps between the various categories. Consequently, the "other formal" or "informal only" segments do not indicate total usage of non-bank formal or informal financial services, only those individuals who have a non-bank financial service but not a bank account, or an informal financial service but no formal financial service. An individual with both a formal and an informal financial product would only appear under formal take-up.

The access strand applied to product markets. The access strand is furthermore used to illustrate take-up across particular product markets (i.e. credit, savings, insurance and payments). The product market access strands also indicate those reached only by "unintermediated" financial mechanisms. These are financial mechanisms that do not imply the intermediation of a third party institution offering a specific service; thus they are not financial products.

Particular financial products, services, mechanisms and activities that have been included for each product market access strand are listed below:

Savings strand

- Formal: Those who save with or have a savings account with a bank or a licensed non-bank financial institution, like microfinance institutions and Savings and Credit Unions. Some of them may also be saving in an informal institution or at home.
- Informal: Those who do not have a formal savings product as defined above, but who save with a village fund or savings group or use mechanisms like livestock or gold and jewellery for saving. Some of them may also be saving at home or in a secret place.
- Saving at home/with household members: Those who do not fall into either category above, but save in a secret place at home, in livestock or in kind, within the household or family, or who ask another person in the community to keep money safe for them.

Credit access strand

- Formal: Having a loan product or credit account with a Bank or any non-bank financial institution that has a license from the designated regulator, like microfinance institutions, Savings and Credit Unions, Lao Postal Savings Institute, pawn shop or licensed leasing or insurance company
- Informal: Those who do not have formal credit, but borrowed money from an employer, trader, village fund or informal money lender. Some of them may also be borrowing from family or friends.
- Family or friends only: Those who do not have formal or informal credit as above, but borrowed money from family or friends.

Remittance strand

- Formal: Those who have sent or received remittances in the last 12 months via bank transfer (or paying into a bank account), ATM, the Post Office, MoneyGram or Western Union. Some of them may also be sending or receiving money through informal channels or family and friends.

- Informal: Those how have not sent or received formal remittances, but have sent or received but have sent or received remittances in the last 12 months directly via friends or family or by using the services of unlicensed providers.
- Family & friends: Those who have entrusted some from their social network to send money on their behalf.

Insurance strand

- Formal: Those with any formal insurance product with an insurance company. Some of them may also belong to a community funeral fund.

Informal: Those who do not have formal insurance, but belong to an informal burial society.

Locality and Use of Financial Services

Urban dwellers are using formal financial services increasingly; however in rural areas this take up is slowed down, partially due to a prevalent use of informal services. The take-up of financial services differs much between locations (Figure 22).

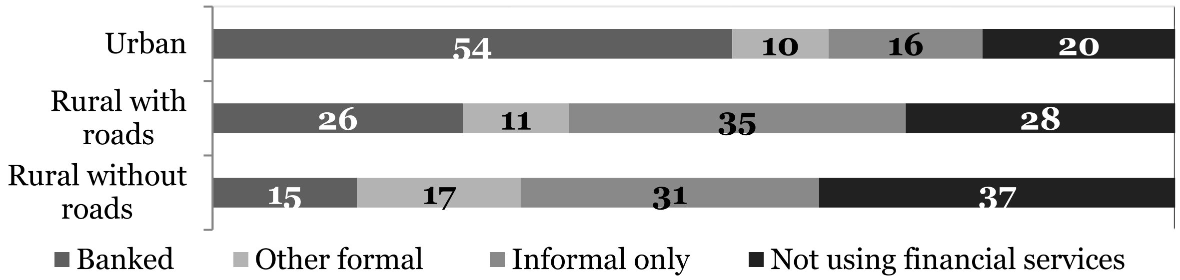


Figure 22 - Locality and use of financial services

Urban areas enjoy a better access to financial services than rural areas. Urban dwellers live in close proximity to formal financial institutions, and thus have access to a broader range of choices and often use several financial products and mechanisms. Urban areas are associated with market integration and a higher level of regular employment, which are main factors for financial intermediation. Hence, there is a considerable gap between rural and urban areas in terms of use of formal financial services; however informal financial services in rural areas partly compensate for the more difficult access to financial services.

Gender and Use of Financial Services

Although women face burdens in terms of lower level of education and lower income, they are using financial services more than men. In Lao lowland culture, women are commonly responsible for family finances' administration, and most men will perceive that women are better in dealing with money than men. In light of these socio-cultural factors, it is not surprising that slightly more women than men are using financial services (Figure 23). The results point to women having a slightly lower use of formal services, and a higher use of informal services, in particular of village funds and ROSCAs.

The FinScope questionnaire did not include questions on ethnicity, therefore further analysis on potential cultural differences is not possible. A segregation of data by ethnic affiliation would likely have resulted in considerable differences in the use of financial services between ethnic groups.

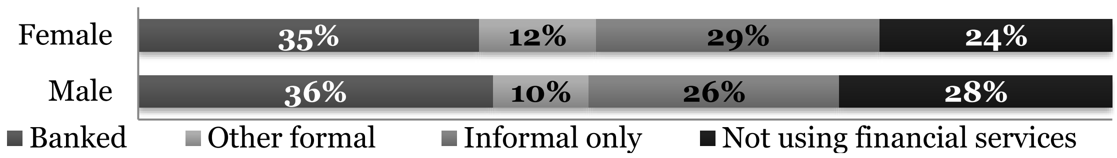
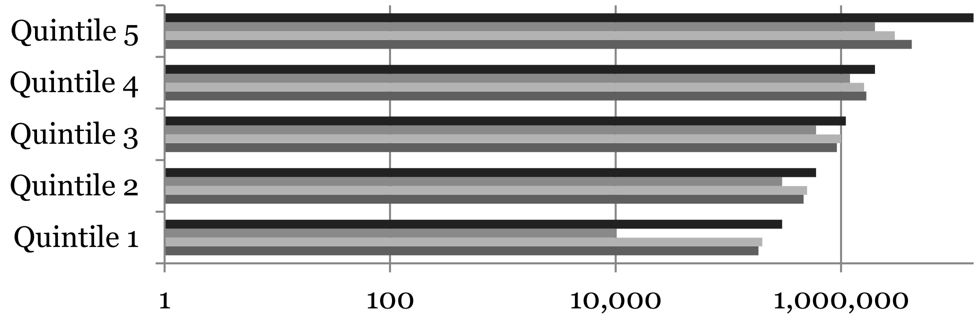


Figure 23 - Gender and use of financial services

Income and Use of Financial Services

Large disparities in the use of financial services between poor and better-off people. For the purpose of analysing the correlation between income and use of financial services, the valid respondent population was divided into 5 equally large income groups or quintiles. The gap between low-income and high-income quintiles is large: only 20% of lowest quintile respondents use formal financial services, and 41% do not use any financial service. On the other hand, the highest income quintile shows 71% using formal services and 11% non-users. The relationship between poor people's usage and choice of financial mechanisms are further elaborated in chapters 2.1 and 5.2.



	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
■ Maximum	300,000	600,000	1,100,000	2,000,000	15,000,000
■ Minimum	10,000	300,000	600,000	1,200,000	2,000,000
■ Median Income	200,000	500,000	1,000,000	1,600,000	3,000,000
■ Mean income	185,001	465,678	919,032	1,680,657	4,235,720

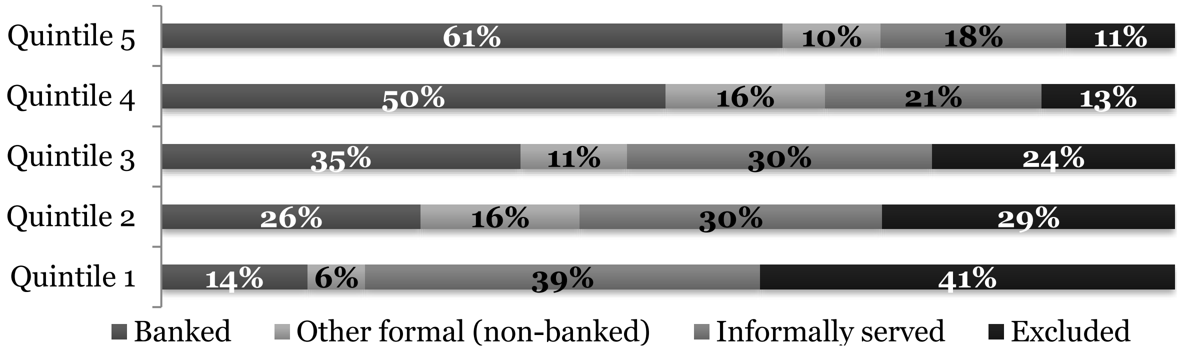


Figure 24 - Income and use of financial services

Age and Use of Financial Services

35 to 55 year old adults are using financial services the most. There are no large differences in use of financial services in regard to respondents' age (Figure 25). However, the age group between 35 and 55 years shows the highest use of financial services. This group also has the highest income[103] with 66% of adults with monthly incomes over LAK 5 mio. belonging to this age group. The initial hypothesis of young people having a higher use of financial services because of their generation's higher education level and widespread employment, could not be verified. Qualitative group interviews in Southern Laos showed widespread consumerism amongst youth with many of them using their income for purchasing expensive clothes and mobile phones.

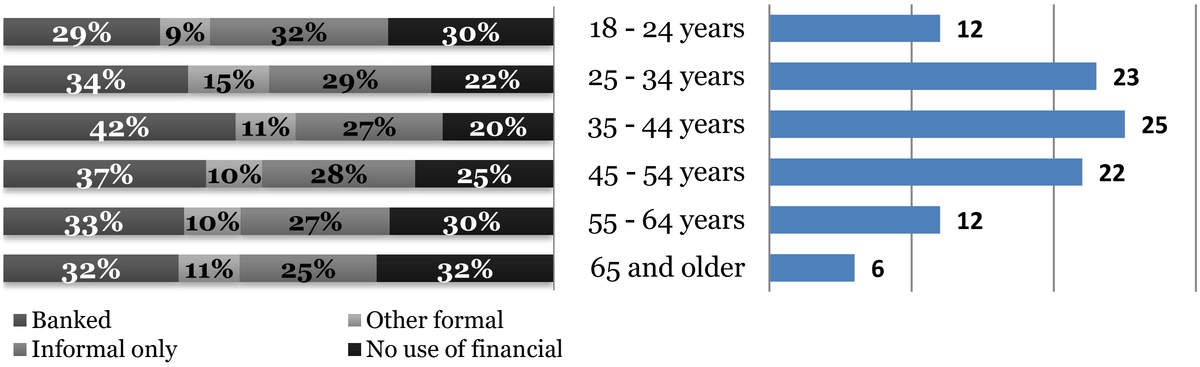


Figure 25 - Age and use of financial services

Education and Use of Financial Services

There is a strong correlation between education and use of financial services. Education is the single most important factor related to the use of financial services. There is strong correlation between the level of adult's education, and the overall use of financial services, in terms of use of formal providers as well as the frequency of multiple use of financial products. 88% of respondents with tertiary education used formal financial services, compared to 22% of respondents without formal education. Besides positively influencing financial capability, education in Laos very much reflects social status, which is correlated with wealth and self-consciousness in dealing with formal institutions.

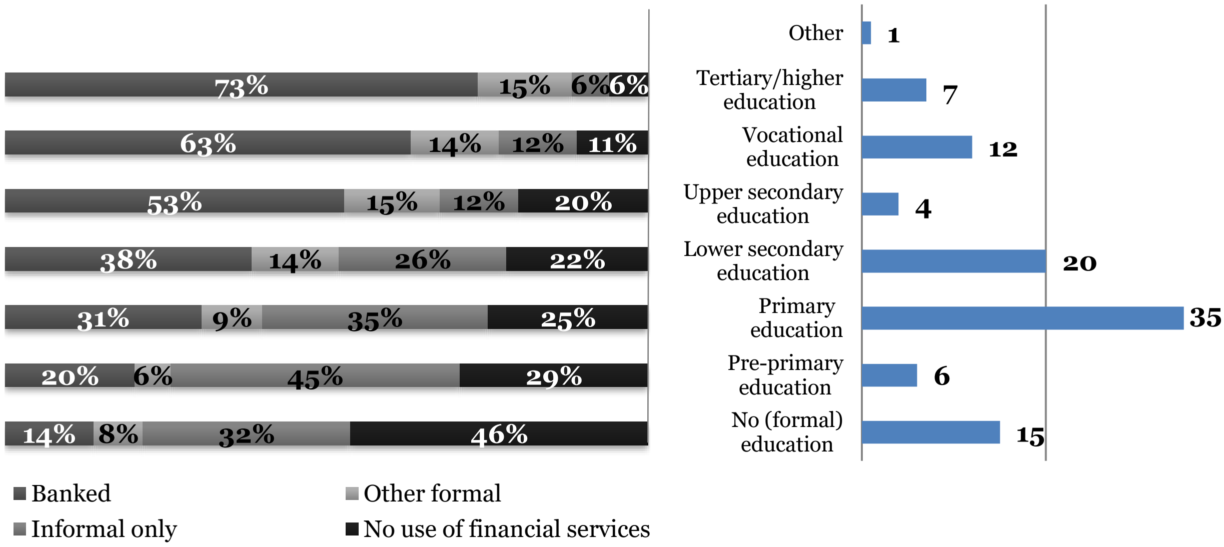


Figure 26 - Education and use of financial services

Regional Comparison

The financial access strand illustrates Laos' status as a low-medium income economy in transition. So far, FinScope surveys in the Southeast Asian region have been carried out in two countries besides Laos, Thailand and Myanmar, both in 2013. The access strand for Thailand depicts a very high penetration of the formal sector, and a very small share of the population being unserviced or having to solely rely on informal services[104]. The financial sector in Myanmar is underdeveloped, resulting in very low levels of financial inclusion.

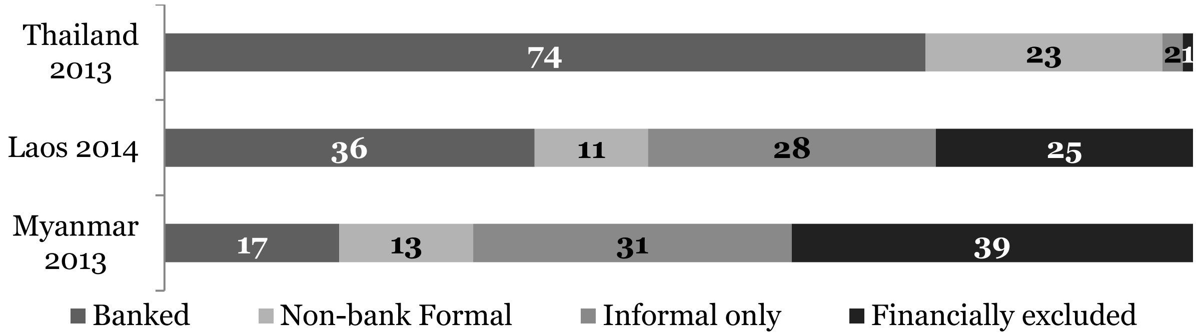


Figure 27 - Access strand - regional comparison

The main drivers for financial inclusion are very distinct according to the three surveyed countries (see Figure 28). In Thailand, the main products used are transactions and insurance, while in Myanmar the main driver is credit from state banks and savings. In Laos, the clear dominating driver for inclusion is savings, with the lowest use of credits out of all three countries.

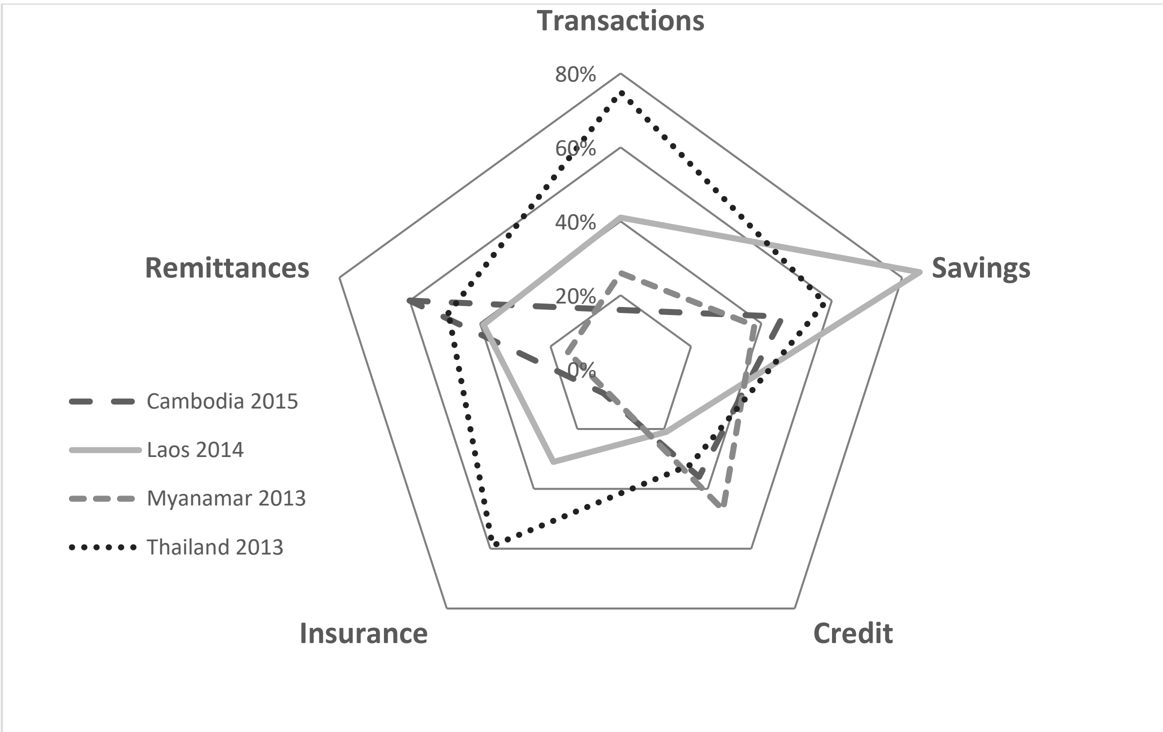


Figure 28 - Landscape of access - regional comparison

4.3 Segmenting the market

Introduction

In order to better understand the nature of demand for financial services and to identify key priority areas for future extension of financial services, the FinScope respondent population was divided into distinct groups. These groups are primarily determined by main individual income source as reported by FinScope. Figure 29 shows which of the income sources eligible in the FinScope questionnaire were included in the five primary target groups: dependents, farmers, informal employees (and farm workers), formal employees and non-farm self employed.

Original income source (from FinScope)	Target group
Pension	Dependent
Remittances (money from other people)	
Money from household member	
Farming	Farming
Sell items collected from nature	
Salary/wages from an individual	Informal employee
Farm worker	
Piece work	
Salary/wages from govt. or state owned company	Formal employee, non-farm
Salary/wages from private company	
Self-employed (own business) - formal	Self employed, non-farm
Self-employed (own business) – informal	
Make goods to sell	
Interest received from money lending	
Money from renting out land or property	
Other	

Figure 29 – Target group segmentation - main income sources declared in FinScope survey

To differentiate further within these still heterogeneous groups, the three largest groups were additionally divided into a low-income and a high-income group, using the groups median income, thereby creating a total of eight target groups[105]: dependents, informally employed, low-income farmers, high-income farmers, low-income formally employed, high-income formally employed, low-income non-farm self-employed and high-income non-farm self-employed. The size and main characteristics of the target groups are compiled in Figure 30.

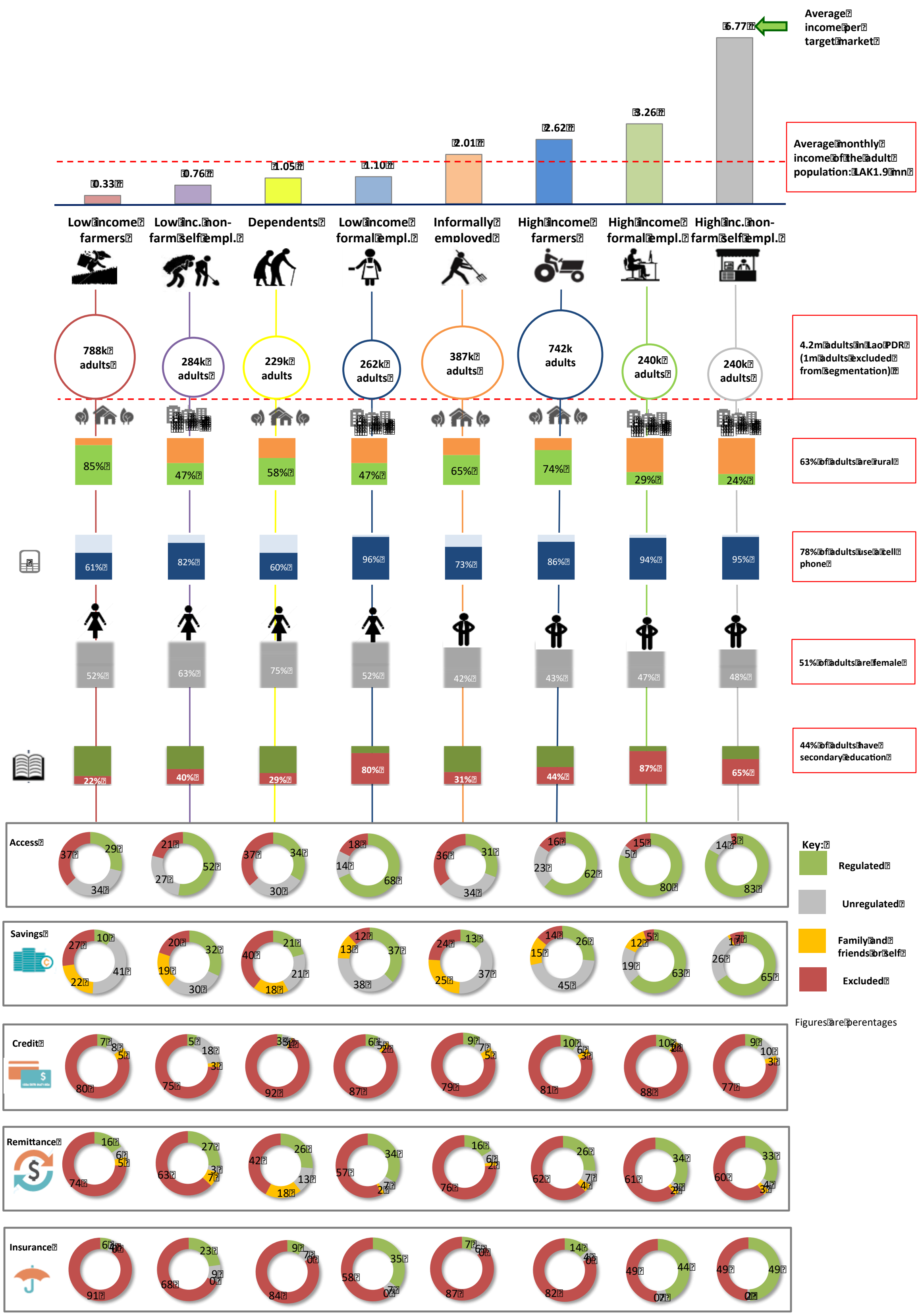


Figure 30 - Main characteristics of target groups

The overall use of financial services by target group is depicted in Figure 31

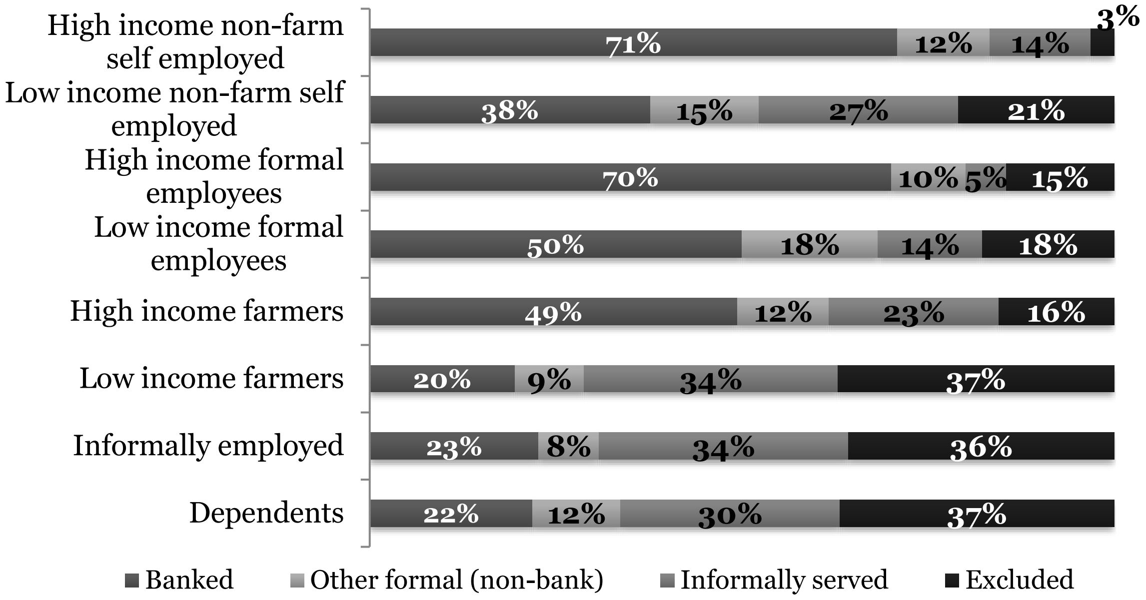


Figure 31 - Overall access strands for target groups

Dependents

Dependents are characterised as individuals who do not receive their main income from their own economic activity, but by transfers from other persons. Elderly or disabled persons are included in this group, as well as students. As FinScope only interviewed individuals who were present at the location of their registration, some young people living at the location of their education without clear affiliation to a household were excluded from the survey. According to the survey, 7.2% of the adult population rely on transfers as their primary source of income.

Only 34% of dependents belong to the main working age bracket between 25 and 55 years, as dependents mainly consist of younger (students) and elderly people (pensioners). The group is also predominantly female (75%). Incomes are mostly low (mean income LAK 1,047,480, median income LAK 800,000); in-kind support is not included as income.

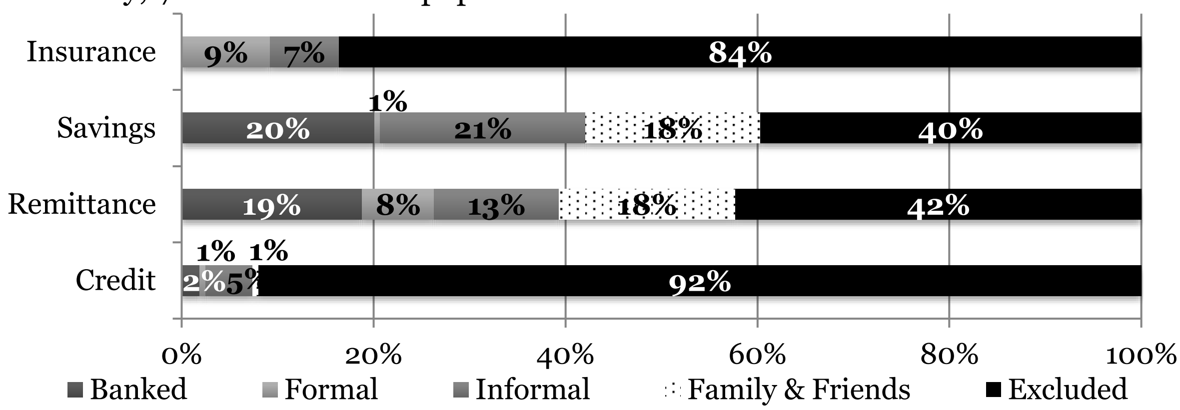


Figure 32 - Access strand - dependents

Dependents mainly use remittance products, for receiving their pensions and family financial support, as well as savings for their own subsistence, while only few dependents rely on credit. The group's high level of debt (LAK 5,4 mio. in average per adult reporting debt) reported by FinScope (see also Ch. 5.3 is significantly high compared to its low level of average savings (LAK 4,0 mio.), although the extent to which debts are related to assets remains unknown. Presumably, part of elderly dependents owns considerable non-financial assets to rely on, while studying young dependents show little debt and own few assets.

Key financial service needs: As this target group is characterised by their limited ability to create income for themselves, financial services facilitating the transaction process from supporter to supported person, as well as financial services facilitating the safe storage of money are the highest priority. Increased outreach of payment services, improved access to convenient and liquid savings and low-cost remittance products will increase financial inclusion of dependents. A combination of both complemented by using transactional accounts for saving will present added value.

Specialised savings products such as high-interest term deposits or retirement saving products can be targeted at better-off independents.

Elderly persons represent a major potential for affordable health insurance schemes, which could prevent them and their family from the shocks of sudden health-related expenditures associated to old age.

Informal Employees

Informal employees are face financial stress. 12.2% of the adult population rely on informal employment as their main source of income. This group consists of farm workers, piece workers, domestic workers and other employees in the informal sector. Many migrant workers are informally employed. Similarly to the students group, migrant workers are underrepresented in the FinScope survey, as an unknown part of them were, at the time of the interviews, not present at the household of their registration. More men than women are informally employed, and a relatively small part of this group is educated: only 31% had an education beyond primary school. Although the mean income, at over LAK 2 mio., is relatively high (median income LAK 1,000,000), so are expenses, as this group relies to a lesser extent on self-produced goods for consumption.

Compared to self-employed farmers and Micro, Small & Medium Enterprises owners, this group is also estimated to possess fewer valuable assets, such as land, buildings and stock. Their average savings only slightly exceed their debt.

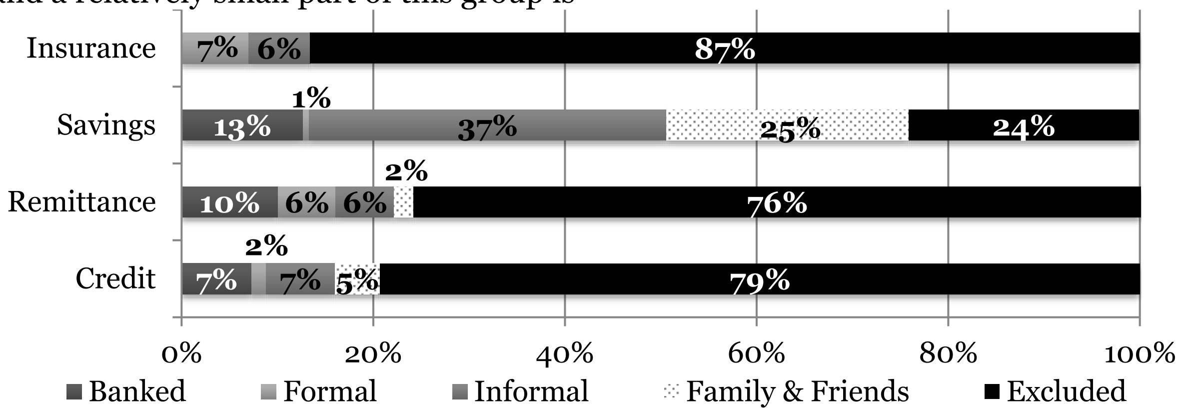


Figure 33 - Access strand - informal employees

This group is underrepresented in the use of all four financial products. However, the informally employed group presents the highest percentage of credit for emergency-related purposes. Informally employed individuals also show a higher level of reliance on informal services. All these factors indicate a high level of financial stress.

Key financial service needs: In light of the unstable income and low asset situation of this group, developing a solid financial buffer in the form of savings is crucial to improving its financial resilience. Savings products with high liquidity can prove to be very beneficial as an improved management system of household finances.

Low-income Farmers

Low-income farmers are heavily indebted. The farmers' group, representing almost half of the adult population, was split at its median income of LAK 600,000. 24.8% of adults belong to the group of farmers with an income below the LAK 600,000 threshold, consisting mostly of farmers producing for their own household consumption with little connection to the market.

This group shows the lowest level of (cash-) income (mean income LAK 333,803, median income LAK 300,000), as well as the lowest level of education. Compared to farmers with high income, fewer low-income farmers live close to urban centres. Women are over-represented in this group as well as in all other low-income groups.

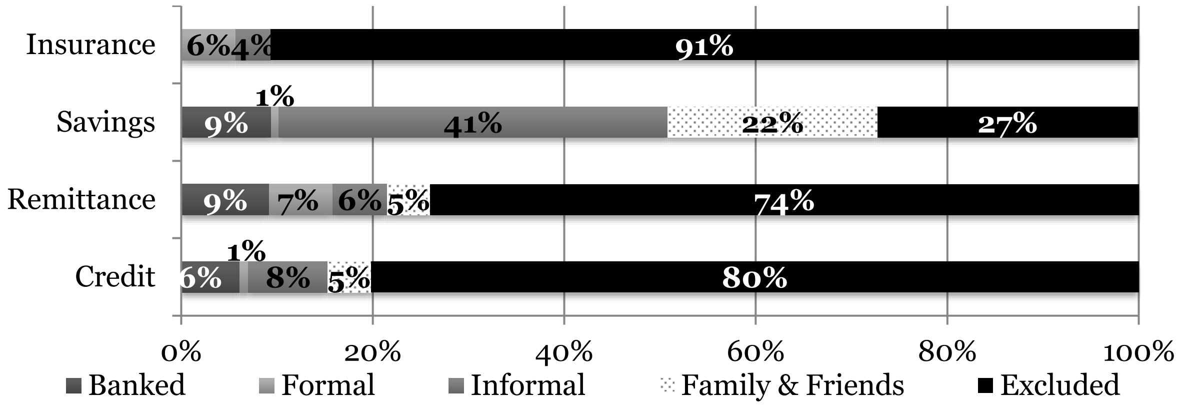


Figure 34 - Access strand - low-income farmers

Low-income farmers show a relatively low use of financial services, and rely to a higher extent on informal providers. However, low-income farmers, despite their low cash income, hold a similar average debt as high-income farmers (LAK 12.7 mio. and LAK 13.0 mio. resp.). It is presumed that the government's policy lending to poor rural households has resulted in this high level of indebtedness. Governmental policy loans are highly concessional, with low interest rates and flexible repayment conditions (see chapter. 3.2). While their objective is to uplift poor households' income, the survey results suggest that investments financed by policy loans have not, or at least not yet, translated into higher cash incomes[106], making this level of debt unsustainable.

Key financial service needs: With its extremely low level of cash income, financial services are not the main issue of this group. Its weak participation in the market economy represents a natural limitation to its demand related to finance services. This group uses financial services to support their fragile livelihoods in case of emergencies and to bridge periods with low income by building a solid savings buffer as well as small, liquid emergency loans. Credit with increasing amounts and longer runtime are suitable for financing activities leading to a certain level of outcome. However low-income farmers' activities, typically agricultural investments, carry very high production and marketing risks that make them unsuitable for viable debt financing.

High-income Farmers

High-income farmers do well economically; their demand for financial services is heterogeneous. 23.2% of adults, almost a quarter of the adult population, belong to the high-income farmers group. The higher than average cash income (mean income LAK 2,620,062, median income LAK 1,500,000) indicates a higher participation in commercial farming and sale of produce to the market. Because of their integration into market economy, their demand and use of financial services exceeds that of the low-income farmers group. High-income farmers possess savings reserves (LAK 24.4 mio.), which can easily compensate for their debts (LAK 13.0 mio.). In addition to good cash income, secured by the possession of land and agricultural equipment, farmers' home consumption and low living costs give this group a solid economic profile.

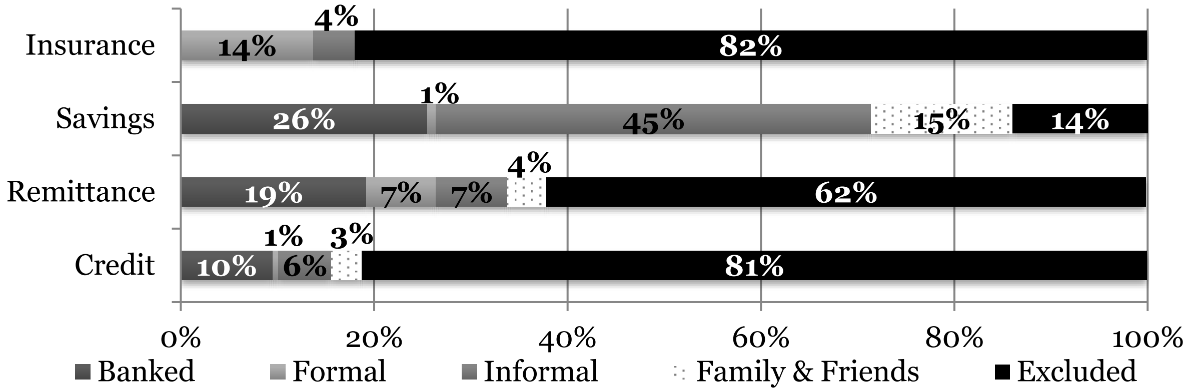


Figure 35 - Access strand – high-income farmers

Key financial service needs: High-income farmers have a strong savings culture. They could benefit from a broader range of financial service choices including liquid deposit services for cash management and less liquid high-yielding products to absorb present non-cash reserves. This group has good connection to the market, with opportunities to expand their production. Credit can prove to be useful for this purpose, though credit products must fit into the cash flow of the financed activity, and must be priced as to match the often low rate of return of agricultural enterprises.

Low-income Formal Employees

The formal employees group consists of government employees and employees in formally registered enterprises. The low-end of this group, with a monthly income of LAK 1.6 mio. or less (mean income LAK 1,098,580, median income LAK 1,200,000), mainly consists of factory workers and low-ranking civil servants, and represents 8.3% of the adult population. They show high levels of education, with respectively 80% and 87% having a secondary or higher education. Low-income formal employees have a strong savings culture. They also use insurance and remittances more than other low-income groups. Many employees get their salary transferred to a bank account, and are thus included in the formal financial system. However, the group has on average a considerable debt (LAK 18.2 mio.), which is not fully compensated by savings (LAK 14.5 mio.).

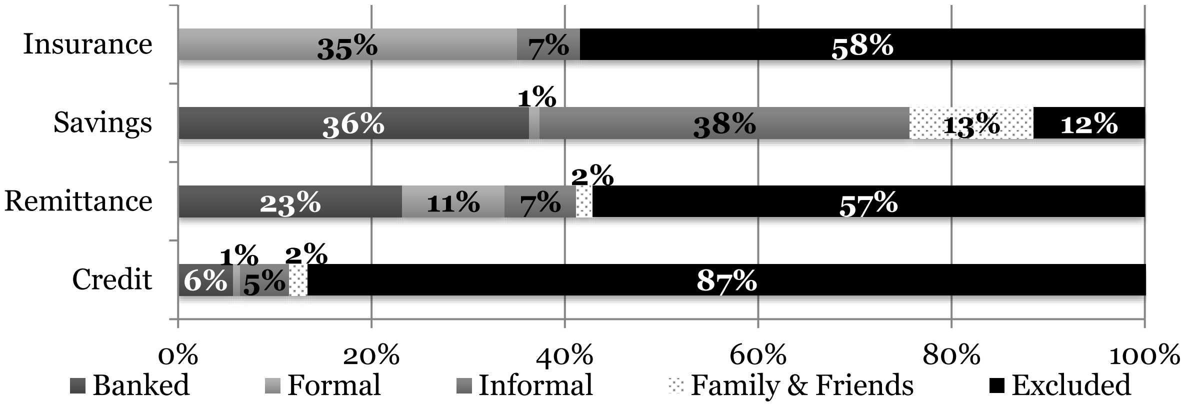


Figure 36 - Access strand - low-income formal employees

Key financial service needs: The primary finance-related needs of this group are the processing of payroll payments, and the safe deposit of surplus income. An increased range of payment and savings products will benefit this group. Tailored savings and credit products can support this group in strengthening their wealth. Leasing in particular, as long as not used excessively, can be an excellent choice for households that lack the financial discipline to set aside income for the purchase of higher-value items.

High-income Formal Employees

High-income formal employees have high, regular income, but also carry substantial debt. This group, representing 7.8% of adults, includes medium- and high-ranking government employees, as well as employees in the middle and upper level of the private sector. Formal employees share a common high education level: 87% have completed a secondary or higher education.

Formal employees have the second-highest income level (mean income LAK 3,256,032, median income LAK 2,300,000), after the high-income self-employed.

They also present a high level of debt in average (LAK 41.2 mio.), but an even higher savings reserve (LAK 69.5 mio.).

Most of their savings (61%) are kept in bank accounts. The use of insurance and payment services is high due to well-paid employees' affiliation with urban areas and regular payroll payments to bank accounts.

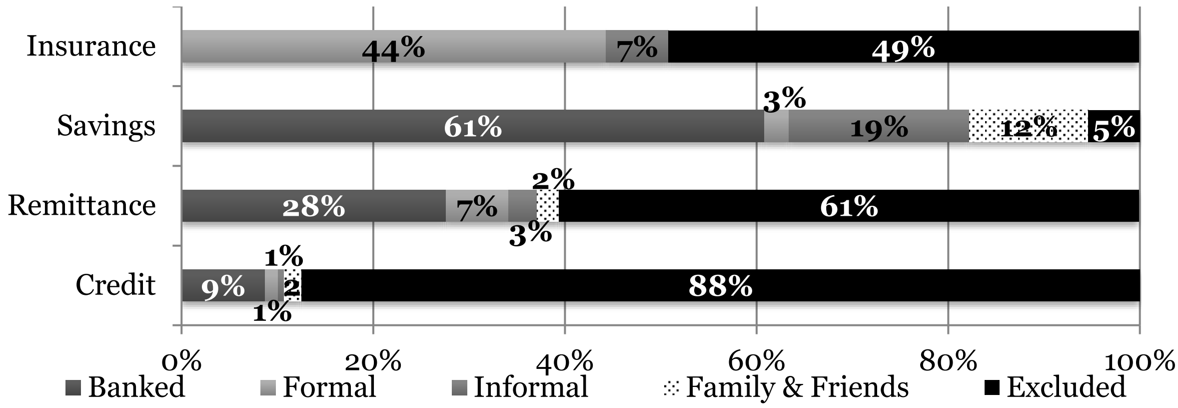


Figure 37 - Access strand - high-income formal employees

Key financial service needs: Being the group with the highest level of education and showing high and regular income, it is likely that most members are able to satisfy their perceived needs for financial services. Similarly to the low-income group, an increased range of payment and savings products will particularly benefit this group; additionally, special savings and credit products can support formal high-income employees to further develop their wealth.

Low-income Non Farm Self-employed

The group of low-income, non farm self-employed, is the group that is most underserviced by the banking sector. It represents 9% of the adult population and includes micro enterprises with an income of LAK 1.5 mio. or less per month (mean income LAK 757,368, median income LAK 800,000).

Almost two out of three low- income businesses (63%) are owned by women. The education level (40% with more than primary education) is significantly lower than in the high-income group. The group shows a high level of indebtedness (LAK 27.4 mio.), which contrasts with its low income and savings (LAK 16.3 mio.). Although the group shows an above average use of financial services, it relies on informal providers to a very high degree. Banks are unable to provide services matching the financial needs of this group. Of all groups, low-income non farm self-employed are estimated to be the most underserviced by the banking sector.

Despite their intensive cash flow, most micro and small enterprise owners have to turn to informal mechanisms, as they are unable to satisfy banks' requirements for collateral; additionally bank products may lack the convenience and adaptability required by this group's economic activities.

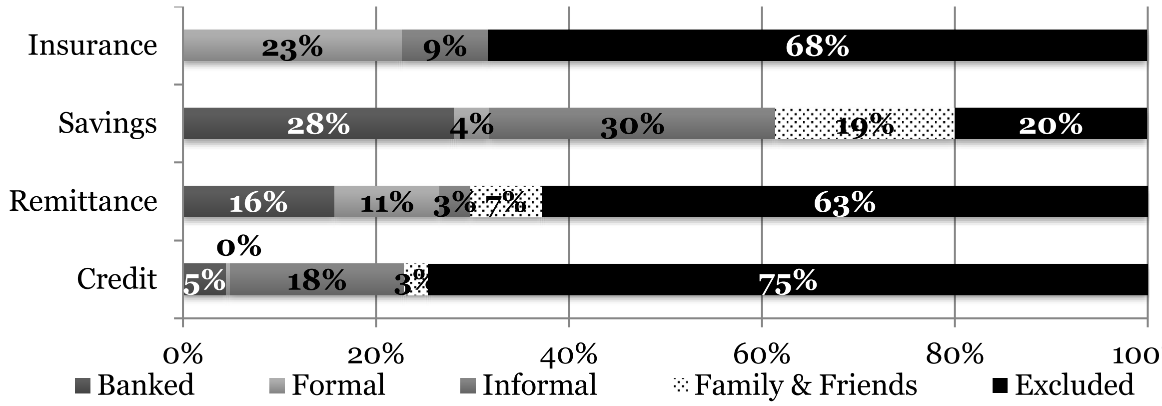


Figure 38 - Access strand - low-income non-farm self-employed

Key financial service needs: Financial products providing support to this group in terms of managing their money flow, such as current accounts or bank overdrafts, will be highly beneficial. Low-income self-employed face difficulties in obtaining bank credit. Therefore, special credit products for SME-lending, focusing on cash flow rather than on collateral and repayment schedules fitting into the businesses' cash flow, will enrich the range of financial products available to this group.

High-income Non-Farm Self-employed

Although few respondents in this group are owners of larger enterprises, the majority owns well-performing small and medium-size enterprises. High-income non-farm self-employed represents 7.6% of the adult population.

This group has the highest income of all groups (mean income LAK 6,767,468, median income LAK 3,000,000). It is strongly affiliated with urban areas (75% urban). Alongside with the two formally employed groups, this group also shows the highest education levels (65% with secondary education or higher). Carrying the highest level of debt, this group has succeeded in having very substantial amounts of savings. Generally speaking, the group are in a comfortable economic position. However, its low use of credit is surprising: only 23% of SME owners in this group reported to have debt.

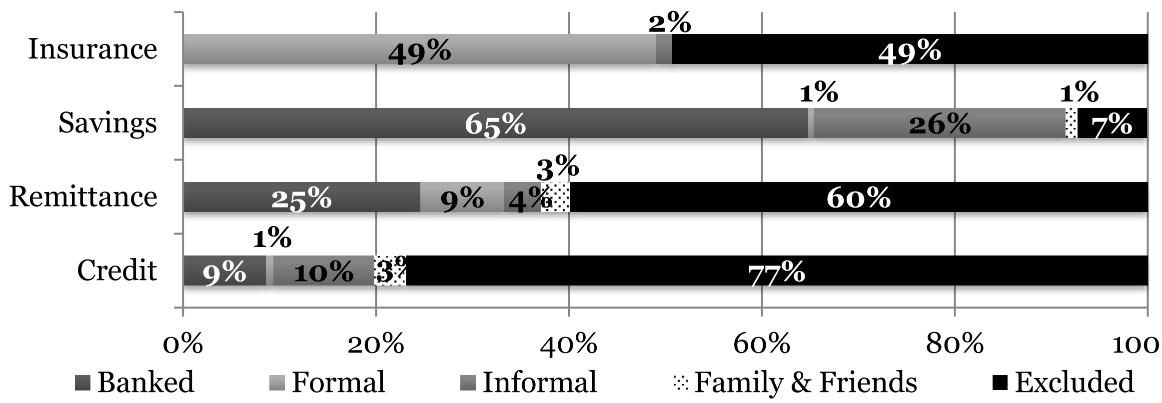


Figure 39 - Access strand - high-income, non-farm self-employed

Key financial service needs: In view of the size of this group's savings and income, it can be assumed that its members are not excluded from financial services, but that they choose not to extensively use debt financing. However, tailored account and credit products have the potential to facilitate business owners' finances management. This group would especially benefit from participating in a cost-efficient non-cash payment system.

The identified needs of the target groups are summarised in

Table 16.

Table 16 - Key financial needs of target groups

Target Group	Unmet financial needs
Dependents	Increased outreach of payment services, improved access to convenient and liquid savings and low-cost remittance products
Informal Employees	Savings with high liquidity
Low-income Farmers	Emergency and bridging loans and savings services
High-income Farmers	Liquid deposits for cash management, high-yielding deposits as monetary reserve, low-cost, risk-balanced credit
Low-income Formal Employees	Processing of payroll payments, increased range of savings products, special credit products: leasing
High-income Formal Employees	Increased range of payment and savings products, special credit products
Low-income Non-farm Self-employed	SME credit products, business account solutions (current accounts and bank overdrafts)
High-income Non-farm Self-employed	Tailor-made credit products, business account solutions and non-cash payments

5 PRODUCT MARKET ANALYSIS

5.1 Introduction

Chapter 5 aims at capturing the market for the four main financial products – savings, credit, payments and insurance. The current usage of each product is analysed in totality, in relation to demographic and economic main characteristics and in relation to the target groups as identified in chapter 5.3. The analysis of use cases and use mechanisms intends to give additional background information. An overview of active providers with their presently available products provides a picture of the present supply situation. Finally, regulatory issues and other gaps that impede the provision of the particular products, and opportunities for their promotion, are listed.

5.2 Savings

Current Usage

The use of savings in Laos is high, making it the overall main driver for Financial Inclusion (Figure 21). Many Laotians are savings members in village funds or use other savings mechanisms like livestock, gold and jewellery, but a large part of the population does also keep an account at a formal financial institutions, usually a bank. Figure 40 shows the use of savings access strand for the adult population, both without (on top) and with overlaps (as explained in Box 2)

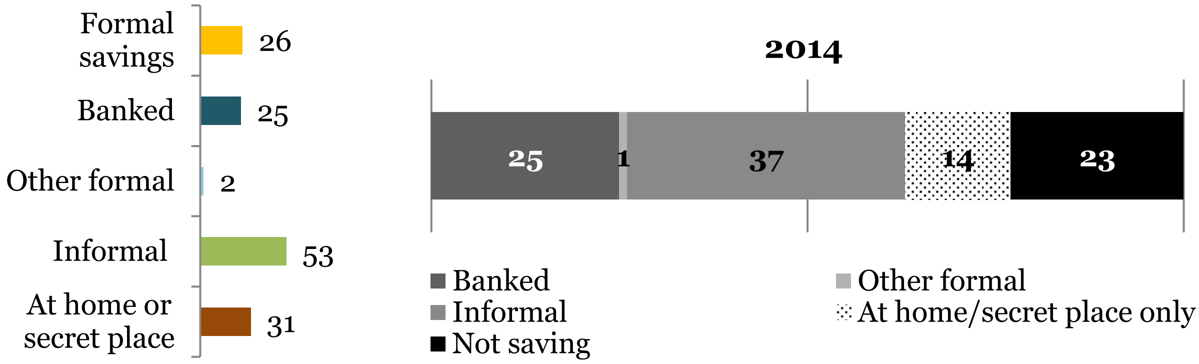


Figure 40 - Savings access strand

As seen in, both cash and in kind savings are prevalent. The majority of urban residents prefers to use a financial product. Unsurprisingly, livestock savings is more common in rural areas, and urban dwellers have more savings in financial institutions. Cash saving at home is equally used in all locations.

	Total	Urban	Rural with road	Rural without road
Secret place at home	28,4%	27,8%	29,0%	24,9%
Livestock	22,5%	13,7%	28,3%	19,6%
Commercial Bank	20,6%	35,4%	12,5%	5,1%
Village savings group/Village bank	14,2%	20,0%	10,8%	10,4%
Jewellery or gold	6,9%	8,6%	6,3%	1,1%

	Total	Urban	Rural with road	Rural without road
Other	6,8%	5,3%	6,3%	16,4%
Family member/friend	4,7%	5,2%	5,5%	1,3%
In kind	2,9%	2,8%	2,8%	3,3%
Micro-finance Institution	0,8%	0,4%	1,0%	1,1%
Savings and Credit Union	0,3%	0,8%	0,0%	0,0%

Location is an influential factor for savings behaviour. Rural residents are stated to hold considerably less savings than urban residents (Figure 41). Low-income target groups, especially the large group of low-income farmers, are overrepresented in rural areas. Low income has a negative effect on the ability to make savings and on the use of financial services. Rural residents' economy consists to a larger degree of non-monetary activities – subsistence agriculture and barter. Therefore, their use of non-financial savings (livestock, unsold produce) is more significant.

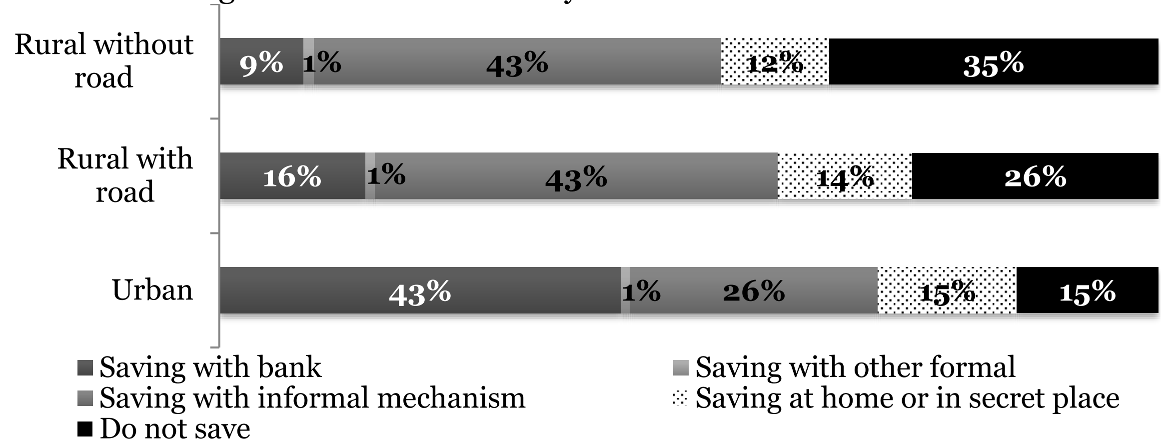


Figure 41 - Savings and location

There is good gender balance in the total use of savings mechanisms (Figure 42). Women, more than men, use savings products at banks and at village funds and Rotating Savings and Credit Associations ('Lin Houai') that are often run by females, or dominated by female members.

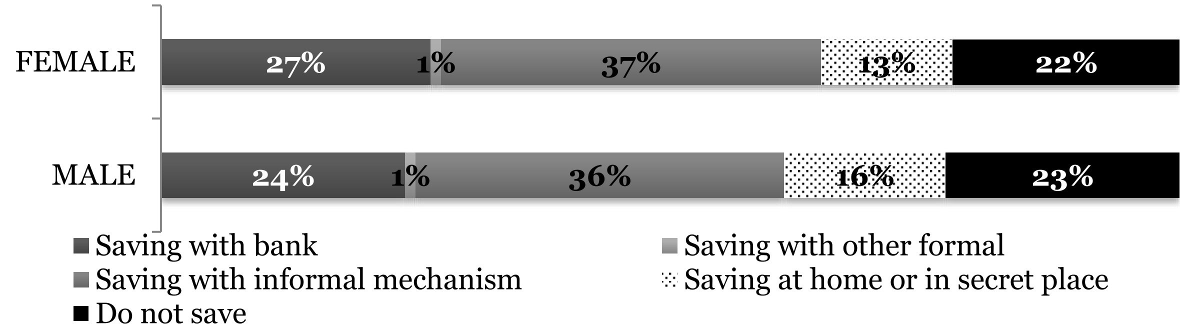


Figure 42 - Use of savings and gender

The variation in savings rates across age groups is rather small – between 72 and 80% within each group saves (Figure 43). This variation is in line with life-cycle hypothesis: There is a propensity for people of working age to save more. Young families' lower income level though, and their labour constraint – young children that require care and do not yet contribute with labour – are factors reducing their ability to make savings. Young people save least, despite their advantage of better education and the higher share of young people with cash income from salary. Anecdotal reports, though, tell about 'youth spending their income instead of saving[107]'.

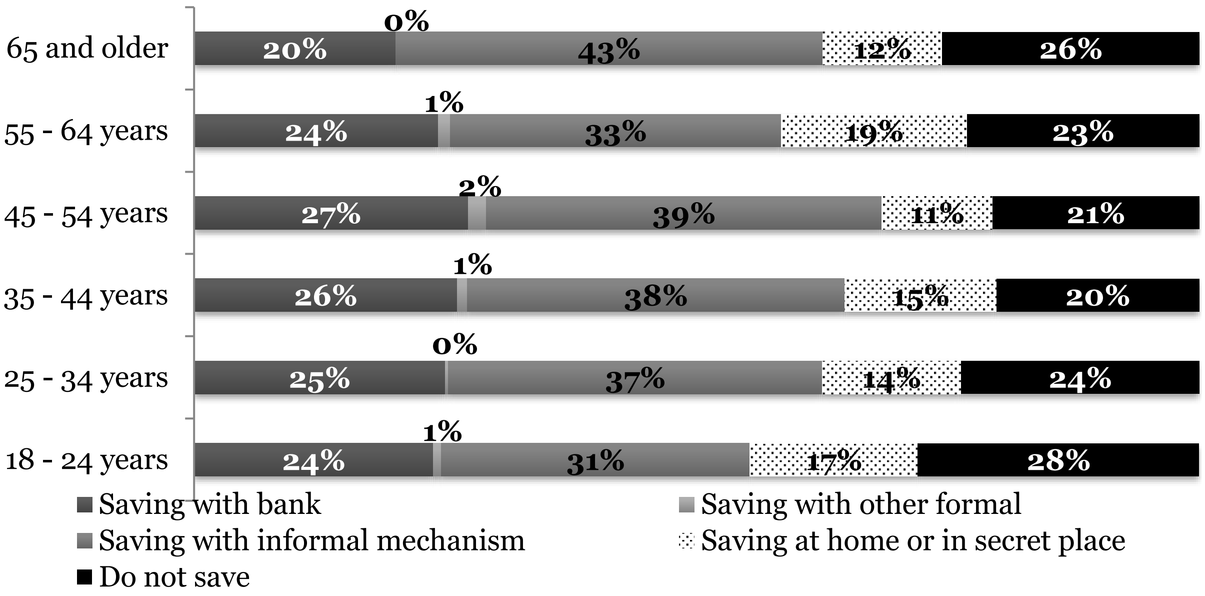


Figure 43 - Savings and age groups

The level of education has a huge impact on people's savings behaviour (Figure 44). The higher the education, the higher the use of savings, and especially of formal savings.

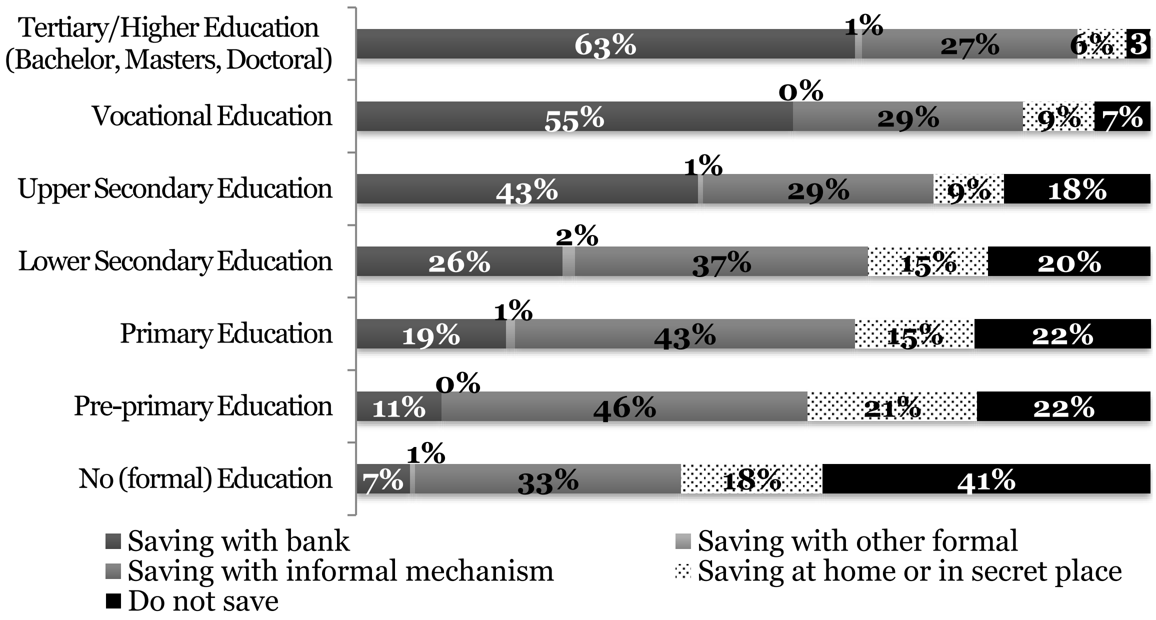


Figure 44 - Savings and education

All target groups share a high use of savings as a financial mechanism. Dependents, informally employed and low-income farmers though save less, reflecting their lower and less regular income. Farmers and informally employed mainly rely on informal mechanisms, while formal employees and non-farm self-employed adults have a higher propensity to use formal services for saving.

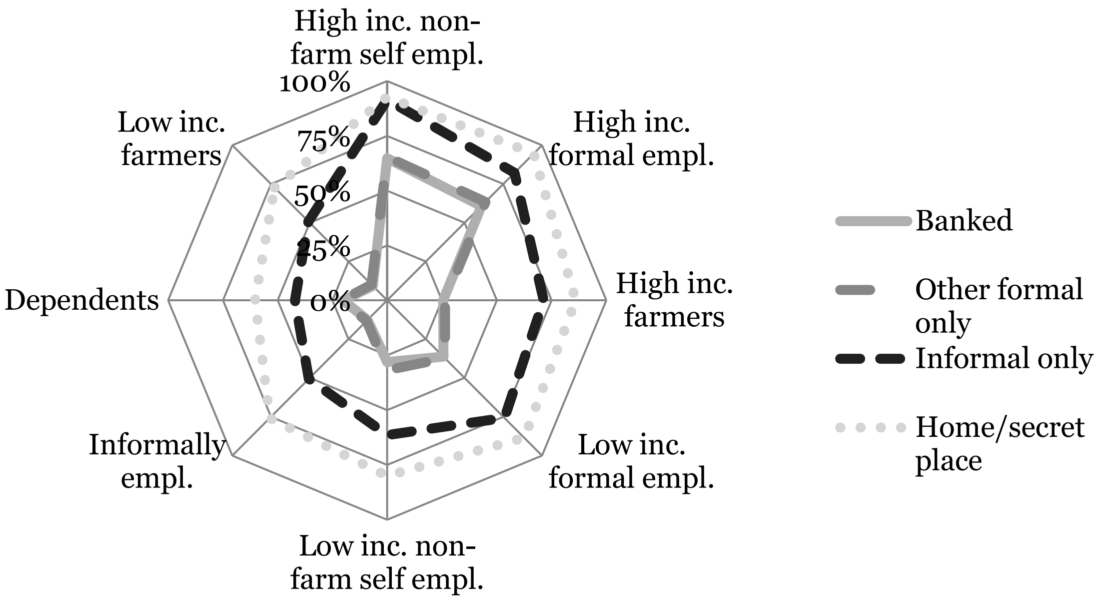


Figure 45 - Savings access strand by target group

All savers' average value of savings is LAK 6 million. Savings values are highest for bank deposits and in kind savings (Jewellery, gold and livestock), while savings accounts at non-bank financial institutions have a relatively low savings balance (Figure 46).

The large difference between mean and median values is due to a small number of respondents reporting very high savings amounts.

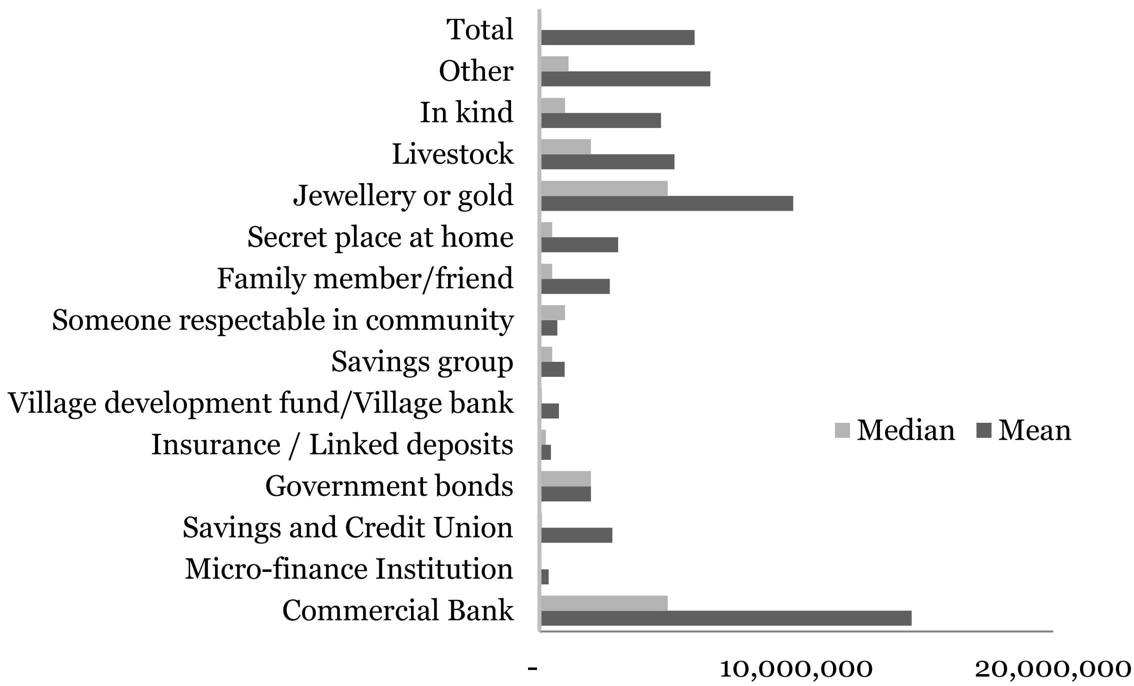


Figure 46 - Mean and median savings amounts per mechanism

The savings buffer varies widely between target groups and income quintiles, with poor people and people with insecure uncertain conditions saving a bigger share of their income. It is hardly surprising that income is strongly correlated with the value of the person's savings (Table 17). The higher income, the larger is the savings reserve. Although the ratio of savings to monthly income is relatively consistent between the income quintiles, it is considerably higher for the quintile with the lowest income. It is particularly the target groups with unstable income – the self-employed farmers and non-farmers - that tend to keep a savings buffer that is larger compared to their income. On the other hand, the informally employed, despite their relatively high average income, and the dependents have reserves that are equivalent only to less than 4 resp. 7 months' income.

Table 17 - Average monthly income, savings and savings/monthly income ratio per adult, by target group and by income quintiles

Target Groups and Savings Value	Average Monthly Income	Savings Value	Savings/Monthly Income ratio
Dependents	1,047,480	7,240,976	6.91
Informally employed	2,008,216	7,650,263	3.81
Low income farmers	333,803	7,000,520	20.97
High income farmers	2,022,414	26,492,218	13.10
Low income formal employees	1,098,580	15,521,231	14.13
High income formal employees	2,894,224	78,193,808	27.02
Low income non-farming self-employed (MSME)	757,368	20,129,614	26.58
High income non-farming self-employed (MSME)	4,025,875	109,768,949	27.27
Income Quintiles and Savings Value	**Average Monthly Income**	**Savings Value**	**Savings/Monthly Income ratio**
Quintile 1	185,001	6,281,698	33.95
Quintile 2	46,678	7,680,543	16.49
Quintile 3	919,032	16,925,952	18.42
Quintile 4	1,680,657	24,138,907	14.36
Quintile 5	4,235,720	82,764,224	19.54

Use Cases and Savings Mechanisms

The distinction between liquidity reserve and savings is not clear-cut. According to FinScope, 23% of adults in Laos have the perception that they do not save. However, virtually everybody is saving in the sense that a part of one's income is not spent immediately, but kept to smoothen consumption and as liquidity reserve. A part of one's earnings is retained to align disposable income with the need for future expenditures. Although – when asked for their understanding of the term savings - 83% of respondents mentioned savings as a mechanism to put money away for later use, 59% of them assigned a time frame of one year or more to make retained earnings count as savings. 30% had a shorter timeframe, one month, one week and even one day (20%, 4% and 6% respectively).

The importance of a liquidity reserve increases with the degree of insecurity and irregularity of income which are particularly important for poor people and people with income from small businesses, especially from agriculture. Only 5% felt to be in a position with sufficiently secured income or assets that they didn't need to make savings at all.

Savings as purposeful accumulation of assets. Savings is also the purposeful accumulation of assets for more or less specific future purposes that typically require larger lump sums. 72% of adults defined savings as putting money away to make it increase over time, or for use for a specific purpose. In fact, it is difficult to make a clear division between the two understandings of the term savings. Accumulative saving requires the conscious deferment of expenditures and the diversion of a portion of disposable income from immediate consumption. Such savings are typically kept somehow physically separate from the liquidity reserve also with the aim to keep them safe. 68% of respondents defined savings as 'putting money away in a special place or account for the money to be safe'.

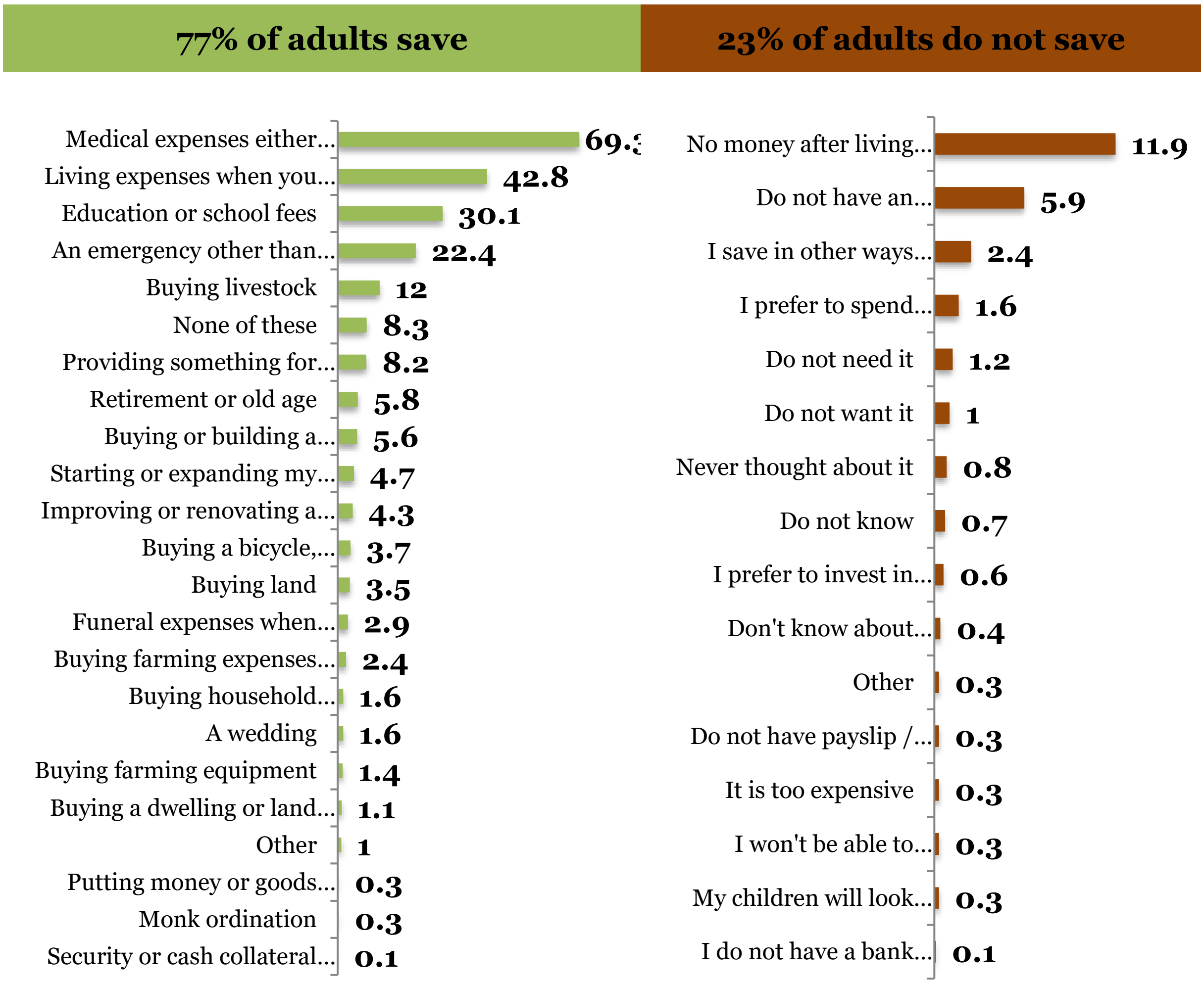


Figure 47- FinScope - main drivers and barriers for savings

Savings are the most widely used insurance product. Not all future expenses can be planned. The living conditions especially of poor people are characterised by high risk. Farmers lose their crops to pests, diseases and natural disasters, or their livestock to diseases or theft. Accidents or human diseases can hit the family at any time, resulting in expenses, loss of assets and loss of labour. As formal insurance usually has little penetration amongst them (see chapter 5.5), poor people use other risk-mitigating mechanisms. The building of a buffer of savings for use in emergency situations is the most prevalent. Medical expenses and other, non-medical emergency situations are the main reasons for adults to save.

Saving for life events. Another major purpose for making savings is the need to finance major life events like marriage, child birth and funeral, as well as the annual religious festivities. 76% of adults reported to pay for such events from savings, either monetary or in kind (Figure 48).

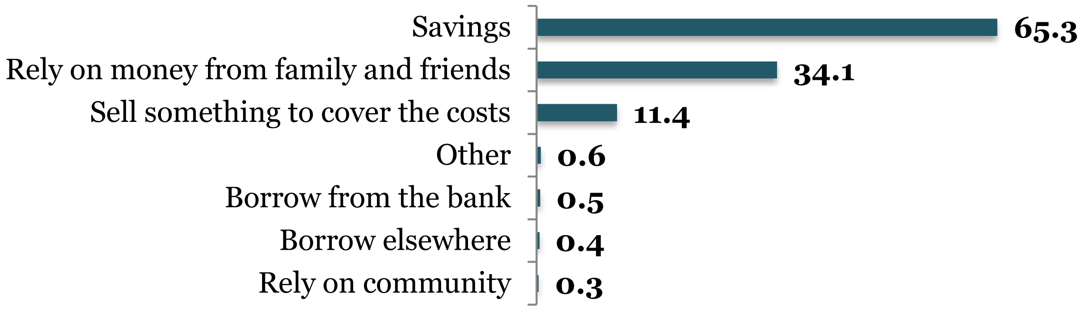


Figure 48 - Mechanism to pay for major expenses experienced in the last 12 months

Savings for old age provision. 63% of adults mentioned savings as their main mechanism for old age provision (see chapter 5.5 – Uses Cases and Insurance Mechanisms)

Building the household's assets by saving. 50% of saving adults stated they were saving for 'developmental reasons'. This category covers a broad range of activities with the assumed main aim of developing the household's asset situation, either by investing in business activities or by saving for durable household assets, like housing, vehicles or high-value household goods. These activities include education or school fees; buying a bicycle, motorcycle, car, pick-up truck or other transport; buying, building or improving a dwelling to live in; buying a dwelling or land to rent out; buying land; buying farming equipment; buying farming expenses such as seeds or fertiliser; starting or expanding a business or business activities of the household; and putting money or goods into someone else's business.

Investing in monetary savings with the purpose of earning a revenue. Better-off individuals can invest their surplus wealth in term deposits in order to create income from interest revenue. This group is a minority[108].

Barriers to savings, as perceived by respondents, mainly relate to financial stress and attitude. The majority of adults not saving stated financial stress as the reason; they had no income, or expenses were so high that there was no scope for putting money aside (see Figure 47). For others it was their attitude that prevented them from saving.

Using a financial product is only one savings mechanism out of many. Savings in the broader sense can be kept in various ways: as cash kept in the pocket, wallet, or at a locked or secret place. One can entrust other people to keep it. Unsold surplus produce, like rice or livestock, can also be a way to accumulate assets for later use. Especially livestock, stored surplus produce, and partly also land, have traditionally multi-purpose roles as productive assets, savings vehicles and symbols of wealth. Of the persons claiming not to save, 11% nevertheless said they used other forms of savings. Savings can also take the form of other durable assets, like gold or jewellery.

Savings that are not financial products. Savings in cash are unbeatable in terms of liquidity (unless an ATM is just around the corner), however they are not safe and do not give financial yield. Nevertheless, in many village communities, the risk of theft is very low. The liquidity of cash savings can also be a problem due to the temptation to spend such easily available resources for short-sighted, immediate consumption.

Gold and jewellery have a traditional role as value storage for girls and women. In addition to the effects of embellishment and display of wealth status, they were an essential part of many households' asset reserves in times when banks were not available and the national currency unstable.

Savings in cash and valuables, although important objects of value for most individuals, are – from a macroeconomic perspective – idle resources, as they are not recycled into productive activities.

Households with connected enterprises also can chose to retain some of their surplus produce, like rice or other non-perishable products, or even to reinvest surplus liquidity into productive assets, like livestock. Historically, raw opium was commonly used as currency and value storage in remote areas in Northern Laos.

Finally, savings can be a financial service offered by a formal or informal financial institution: informal savings, savings accounts, term deposits, possibly with associated services like ATM cards or internet banking.

When the number of active savers and their average amount of savings is considered (Figure 49), the prevalence of bank savings and informal saving at secret places and as livestock and jewellery or gold becomes apparent. The low average values of savings at village funds, microfinance institutions and Savings and Credit Unions indicate these institutions catering to the low-income segment.

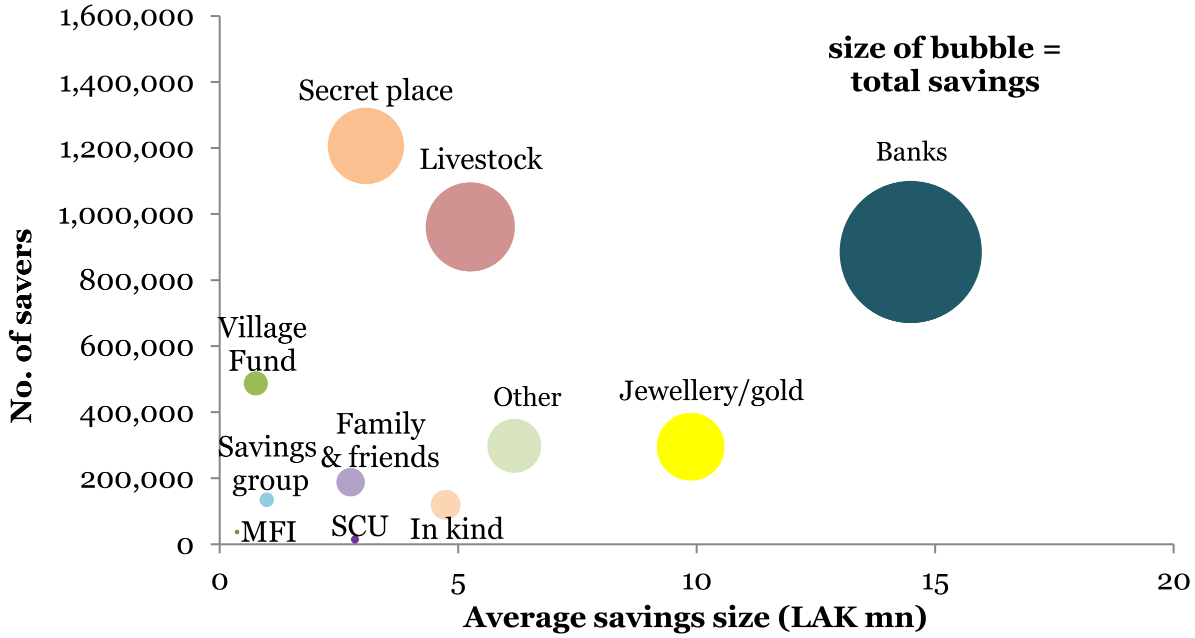


Figure 49 - Savings by mechanism, number of savers and saving amounts

Average indebtedness is still low. FinScope data reveal an average debt of LAK 17 mio. debt per borrower. Amongst the different borrowing mechanisms, debt balances were highest for bank loans, lower though at the Agricultural Promotion Bank than at other banks (see Figure 50).

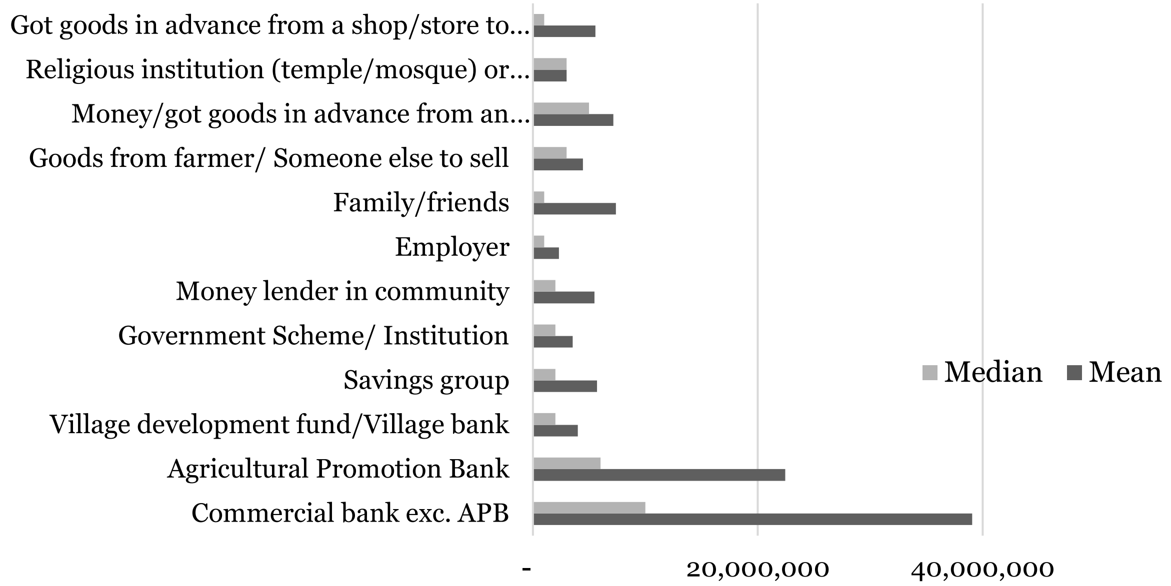


Figure 50 - Borrowing mechanisms and borrowing balances[109]

NB: MFIs and SCUs omitted as no amounts were stated

Products and providers

Criteria for the choice of savings mechanism and product. As far as people have a choice to make, their choice of preferable savings mechanism or product will relate to the relation between perceived benefits and perceived costs.

More specific, savers choose their savings mechanism mainly based on these criteria:

- Liquidity - how easily can we access savings, when we need them?
- Safety - what is the risk for our savings to be lost?
- Transaction costs both for depositing and withdrawal: transport, time, hidden costs.
- Yield - what costs and income are connected with the way we keep our savings?

Also psychological and social factors have influence on the choice of savings mechanism: personal perceptions of benefits and costs are differing from individual to individual. On the other hand, people tend to assimilate to behaviour that is accepted and promoted within their social group.

Liquidity and accessibility are most important when aligning living expenses to income over time. It is also the most important aspect for certain types of insurance. Yield (in the sense of positive return) is important in the case of longer-term savings, and for those who have high levels of discretionary savings.

In the above-mentioned survey on Financial Literacy[110], 72% of the respondents mentioned the bank as the safest place to keep their money - however, only 9% named a bank account being their preferred form of savings. For most respondents, the aspect of safety was not a major concern. Even less, only 4% of respondents were saving particularly to earn income from interest.

On the other hand, the savings interest rate is the most decisive factor, when customers choose the financial institution for its services.

The choice of savings mechanism, savings provider and product depends on the use case. Figure 50 uses the categorisation of use cases into three different non-exclusive stages of demand

- subsistence, advancing and wealth management demand - that are correlated with households' increased wealth, increased income and security of their financial situation. It is intended to highlight the relationship between use cases, their main characteristics and the products and providers that are mainly affiliated with them.

	Subsistence Demand	Advancing Demand	Wealth Management Demand
Use Cases	–Emergencies –Insurance –Consumption reserve	–Lifetime Events (private) –Working Capital (business)	–Asset Building –Investment
Characteristics	–Small amounts –Short time horizon –High fugitiveness –Liquidity/accessibility –Safety	–Increasing amounts –Short-long horizon –High fugitiveness –Liquidity/accessibility –Safety	–Large amounts –Long time horizon –Return –Safety –Accessibility
Providers	Cash Savings		
	Multi-purpose, non-financial saving (Livestock, gold)		
	Village Development Funds, Village Banks		
		Formal Financial Institutions	
Products, channels	–Cash and cash-like (ATM!, digital finance) –Current account	–Current account –Savings account	–Term deposit account
Wealth, Size and Regularity of Income			

Figure 51 - Savings use cases, providers and products *(Source: own)*

The nature of poor households' demand requires high liquidity and easy access. This is difficult for formal institutions to satisfy, unless they can offer quasi-cash products using inclusive distribution channels. Formal institutions can better provide for the demands of households with more regular and secure income that are in the position to build and manage their wealth.

Village funds can be good providers of liquid savings channels. Savings-based village funds, if functioning well, are able to fill an essential gap in this regard. They allow people to keep money safely away from home, and even to earn a good return on them. The monthly savings practices in most savings-based village funds enable people to build a financial buffer. As virtually all of the village funds allow for emergency withdrawals at all times, these savings are also highly liquid.

Many Laotians have an aversion to using banks for their financial demands that is rooted in a mismatch between the formal image of banks and especially low-end clients' self-image. Poor people and rural dwellers do not dare to bring their small issues to a bank, as they are intrinsically shy to expose their low social status at official places. It is a general perception that banks are for dealing with large amounts, even though there in reality is no formal barrier for poor people to be bank customers.

Savings give high return. It is generally inexpensive to open an account in Laos, at both formal and semi-formal institutions; typically the cost is the price of the savings book (Table 18). As the interest rate level is presently high, returns to savings are attractive, especially given the current background of the relatively low inflation.

Table 18 - Pricing of reference savings products *(Source: Providers, as of September 2015)*

LAK	Current account - BCEL	1-year time deposit account - BCEL	Savings account – Patukham DTMFI	1-year time deposit account – Patukham DTMFI	Savings account – Village fund
Fee establishment	10,000	10,000	10,000	10,000	0-10,000
Annual interest rate	0%	6.13%	6%	12%	Dividend: 0 - >30%
Other fees	Maintenance fee LAK 20,000 Withdrawal fee LAK 2,000 from other banks	For untimely withdrawal	none	none	none

The interest rate on deposits has been high (Figure 52), and subject to strong competition between microfinance institutions and private banks. With Lao consumers' preference to deposit at state-owned banks, microfinance institutions and private banks tend to be short of deposits and hence face constrained access to loanable funds. In July/August 2015, the central bank issued two notices curbing banks' deposit interest rate[111] by in average 30%.

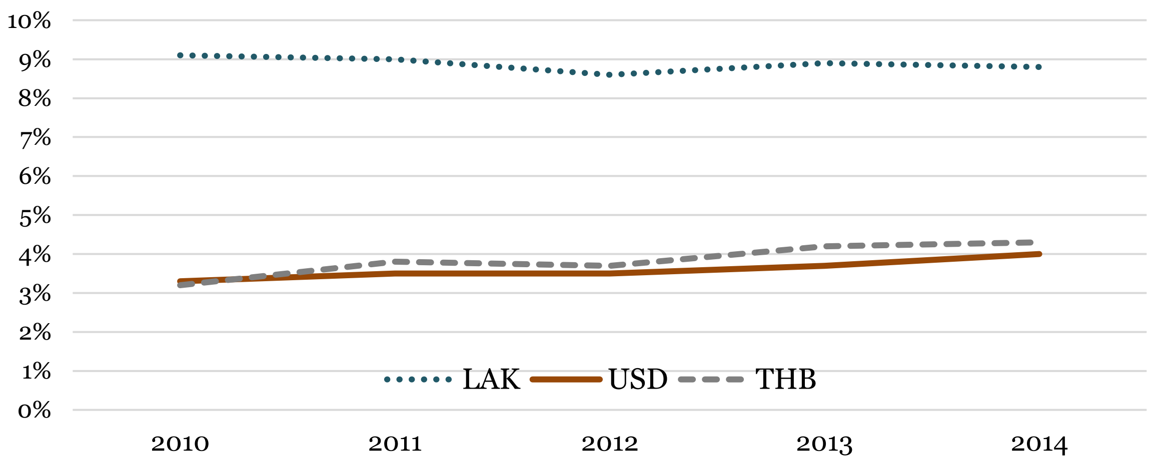


Figure 52- Reference interest rate for 12-months' time deposit in LAK, USD and THB *(Source: BoL, 2015)*

Large potential for the mobilisation of savings. Savings is the main driver for financial inclusion into the financial sector, and there is a large potential for further mobilisation of savings. In the above-mentioned survey (GIZ, 2015) 54% of respondents – with only very few of them presently holding savings at a financial institution - said they could save more than 100,000 LAK per month. Only 11% stated that they could not make savings at all - 44% of these were categorised as poor (Figure 53).

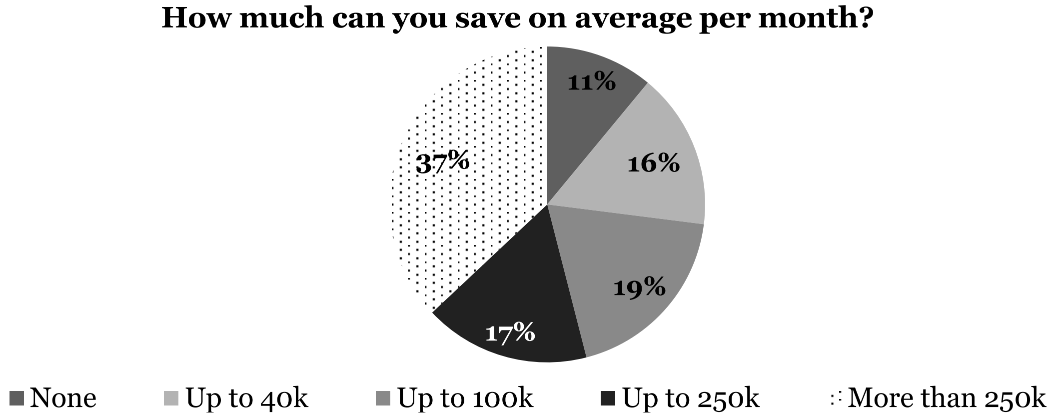


Figure 53 - AFP-FL survey: how much can you save on average per month? *(Source: GIZ, 2015)*

Regulatory Issues

Recent cap on deposit interest rate curbs remuneration of savings. The central bank's recent initiative to stimulate investment by introducing caps on deposit interest rates for all commercial banks has negative implications for savers, and is likely to have unintended side-effects within the financial system. However, as poor clients are inclined to use informal mechanisms for their savings, the effect on financial inclusion is likely to be small. Furthermore, Savings and Credit Unions and Deposit-Taking MFIs are likely to benefit, as they are not subject to the cap. Bank savers see their incentive to save reduced by an interest cap. Competition between banks in attracting saving deposits is strongly reduced. As the cap only concerns bank deposits in LAK, the reduced interest rate spread relative to foreign currencies can lead to conversion of LAK into foreign currency deposits, and to transfers of bank deposits to non-bank or informal financial institutions, or to other, less secure saving mechanisms, which presumably run counter to policy intentions (see also chapter 3.2 – Regulation of the Banking Sector).

Barriers for Non-deposit Taking MFIs to graduate to Deposit-taking MFIs. The present ceiling for Non-deposit Taking MFIs to accept no more than LAK 200 mio. as savings deposits puts NDTMFIs that have reached that scale under pressure to register as Deposit-taking MFI. In the meantime, until they have acquired the relatively high capital requirements and a series of prudential ratios applicable to DTMFI, they are not permitted to accept further savings (chapter 3.2 – Regulation of the Microfinance sector). Partly for this reason, there have been no graduations from NDTMFIs to DTMFIs.

Insecurity of village fund members' deposits. The most important threat to poor peoples' savings is the very high incidence of collapsing village funds (chapter 3.2 – Regulation of Village funds), which are *de facto* unregulated. As most village funds are capitalised by their members' savings, each collapse results in the loss of – often poor - peoples' savings.

Gaps and Opportunities

Government promotes credit, not savings. To provide low-interest credit to alleviate poverty has been a mantra for many years. To strengthen poor people's resilience by building a buffer of safe and liquid savings is presently not a government priority. A dialogue with the strategical-ideological part of the government may create awareness and understanding for the importance of savings and good savings behaviour.

Banks' formal image prevents poor people from using their services. Many 'commoners' never consider to approach a bank, even though there are no factual barriers to do so. Whenever banks decide to use 'microfinance approaches' – e.g. proactive contact at the venue of their customers, products that permit frequent, cost-saving collection of small amounts - they are successful in attracting new customers[112].

Advanced payment channels can attract savings. Poor people's main criterion for the choice of savings mechanism, product and provider is accessibility and liquidity. Any development of convenient payment channels with lower financial and non-financial access costs has the potential to transfer present cash holdings into liquid accounts. The set-up of an ATM network has been a large step into this direction. New approaches (like agent banking) and new technology (like digital finance) can have good potential to attract low-end customers.

DTMFI and SCU cannot become members of the Depositors' Protection Fund (DPF), even though the law requires membership. Although the regulations require SCUs and DTMFI to become members of the DPF, their membership is presently not accepted, as the DPF does perceive microfinance institutions to have high risk.

Village Funds have high potential to absorb poor people's petty savings. For first-time users and for low-income clients, village funds are preferable providers for small and liquid savings services. Rooted in the local community they have a unique capability to mobilise community members to save regularly. However, against the background of the high rate of village fund casualties, their operational standards must be ensured for the protection of depositors. By establishing linkages between village funds and formal financial institutions, village funds could become stepping stones for people unexperienced with financial services to overcome their timidity towards formal settings and become customers of banks or other formal institutions in the medium and long term.

Livestock is a productive savings mechanism, but with high risk. Raising livestock is farmers' traditional mechanism for storing wealth that, at the same time, has built-in growth. The downside is the high risk connected with animal raising in areas where veterinary services and agricultural techniques are underdeveloped. The development of these is of paramount importance to increase income from livestock as well as for preserving the wealth created.

Although Laotians save a lot, few have developed sound savings habits. Even though most Laotians save actively, there is no dedicated savings culture[113]. Knowledge about financial products that facilitate financial activities is low. It is the objective of a financial literacy policy to develop sound financial habits and to disseminate relevant, impartial information.

5.3 Credit

Current Usage

The number of people in Laos borrowing money is small. Only 20% of adults had a loan at the time of the FinScope survey, with formal and informal usage at a similar level (Figure 54). Most notable is the fact that none of the respondents stated that he/she did not take a credit because there was no opportunity to borrow. The low level of borrowing is not directly related to supply-side shortages.

However, FinScope 2014 is likely to understate the actual level of credit use. The survey was done after harvest time, when the rural economy has its annual peak in terms of liquidity, and farmers have paid off a large part of the short-term borrowings incurred during the growing season. Unfortunately, not all debt-financing products were included into the survey, and a substantial underreporting of debt is possible. Leasing, although classified as a long-term rental product rather than a credit product, has conditions and implications that are very similar to credit, but was not included in the survey. Based on qualitative interviews and observations, leasing is likely to be the most used debt-financing mechanism in Laos. Also trader credit is more common than FinScope results indicate. In a survey amongst rice farmers in Southern Laos[114] trade credit was the most used financing mechanism. The 'buy now, pay later' option is often not perceived as credit, but as a special favour, and may as such not be captured completely during the survey.

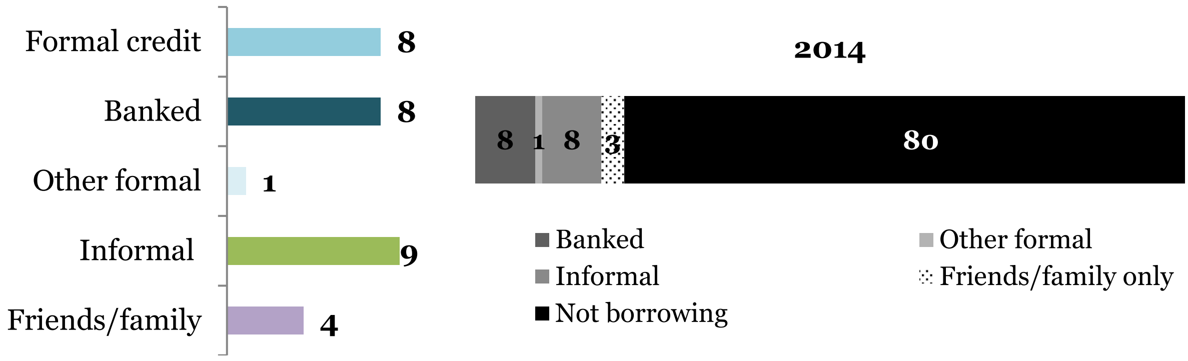


Figure 54 - Access strand credit

Surprisingly, there is little difference in the use patterns of credit products between urban and rural areas (Figure 55) because of increased coverage of targeted credit by the Nayoby Bank and village funds set up by development projects and government organisations.

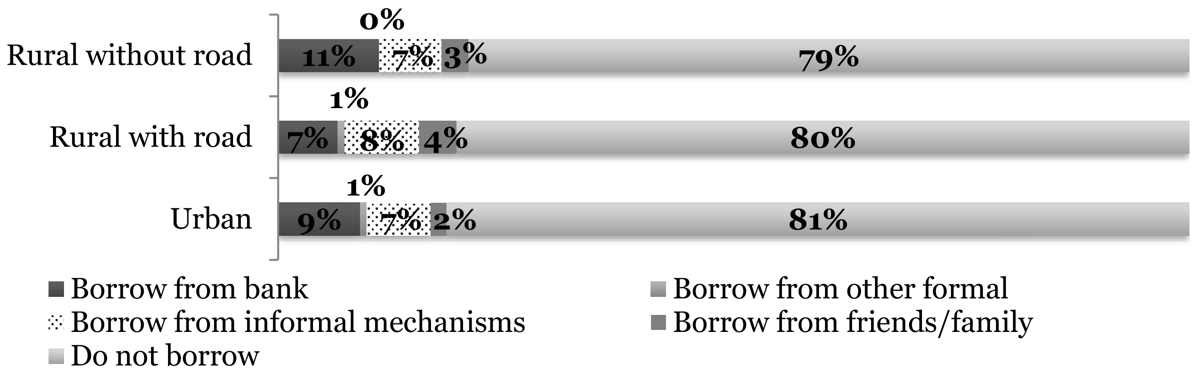


Figure 55 - Credit use and location

There is no significant difference between the use of credit by men and women (Figure 56). There are slightly more female borrowers, with a tendency to use the informal sector more. This phenomenon may relate to the active role of the Lao Women's Union in setting up village funds that in many lowland villages mainly consist of female members.

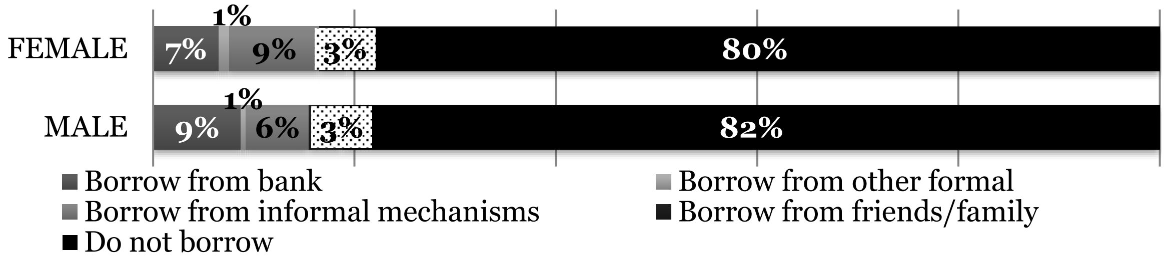


Figure 56 - Use of credit and gender

Similar to savings behaviour, it is the economically most active age group from 35 – 55 years that makes most use of credit financing (Figure 57).

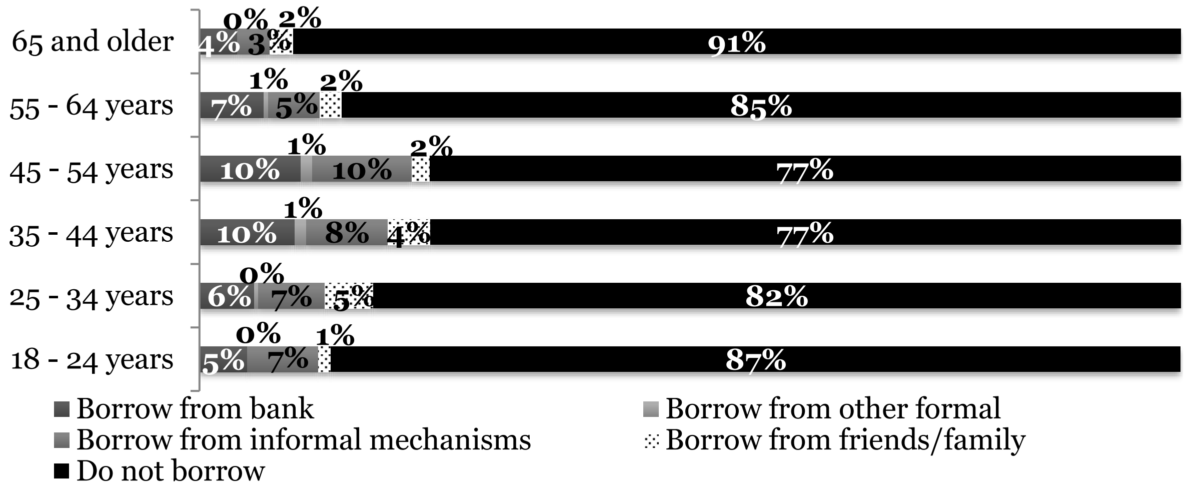


Figure 57 - Credit use and age

Also the correlation between use of credit and education is far less distinct compared to the use of savings (Figure 58). A large share of people with high education is formally employed, and has as such less demand for business financing.

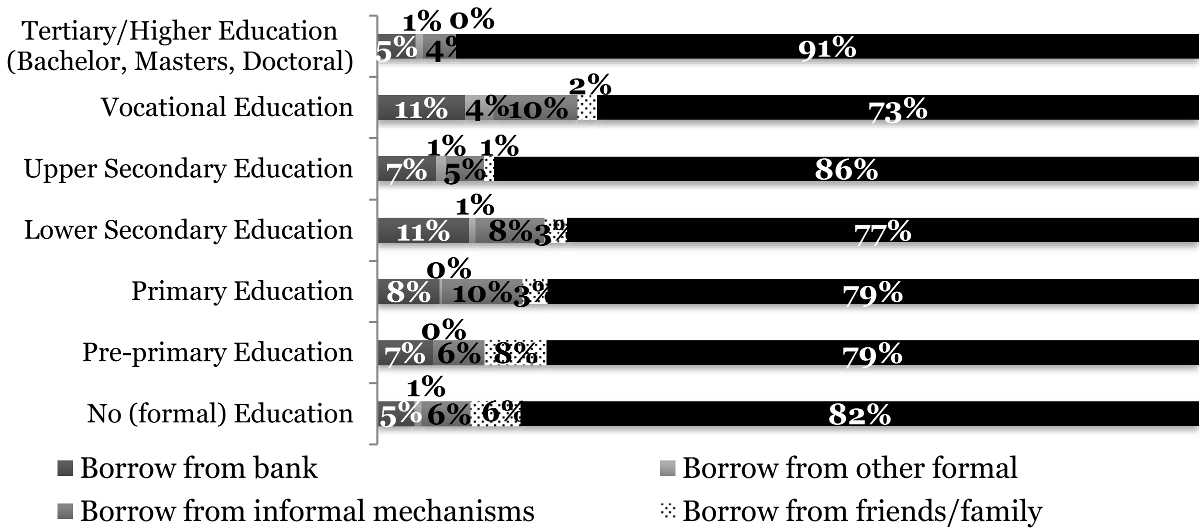


Figure 58 - Credit use and education

Relatively high use of credit amongst farmers and informally employed – SME owners rely mainly on informal credit.

Amongst the target groups, dependents and formal employees have the lowest use of credit, as they have less demand to finance a business as the other groups (Figure 59). Farmers, also low-income farmers, have a relatively high use of credit; so have informally employed. Further mentionable is the high proportion of informal credit used by SME owners. Formal institutions are obviously not prepared to cater for the demand of this group.

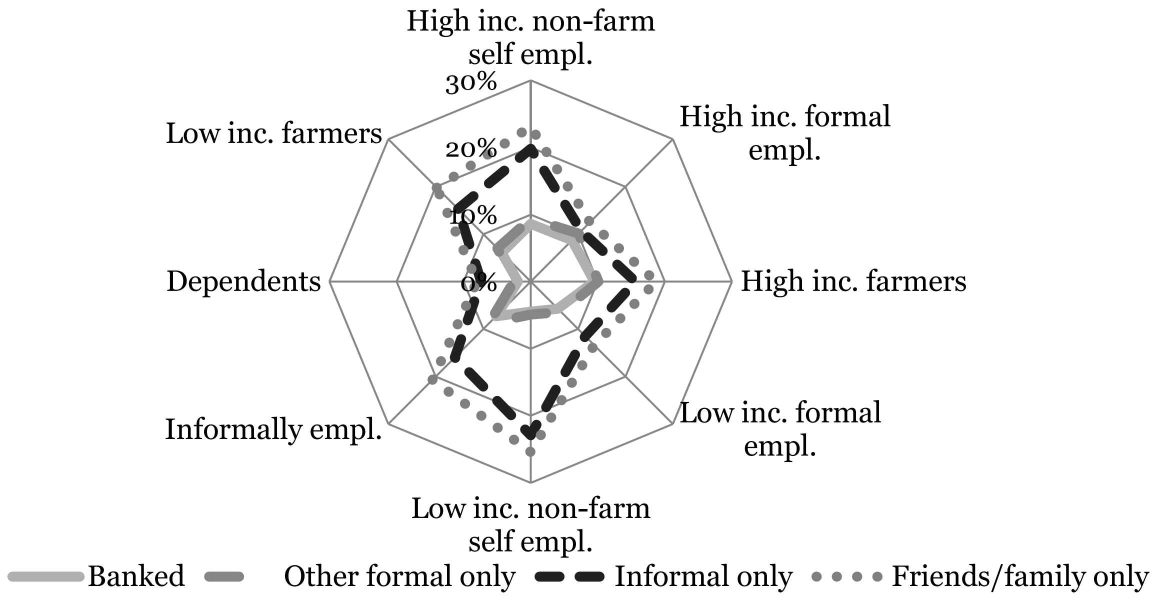


Figure 59 - Credit access strand by target group

The share of bank lending is high. The high use of credit for developmental reasons (Figure 60**Error! Reference source not found.**) is reflected by the high share of bank lending amongst actual borrowers. 41.1% of people reporting to borrow money presently had loans at banks and another 4.5% at non-bank financial institutions. 39.0% reported lending from informal sources, mainly from village funds, and 19.5% borrowed from family or friends.

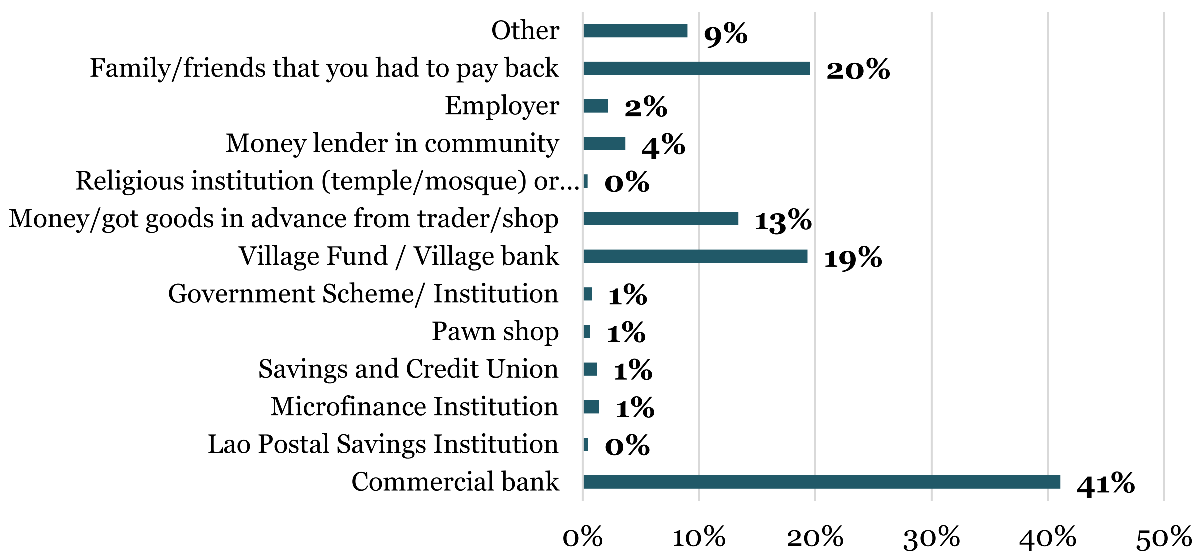


Figure 60 - Credit sources amongst present borrowers

NB: SCUs and MFIs omitted as no loan amounts were stated by the borrowers.

On the whole, private average indebtedness in Laos is still low. Compared to other countries, the level of private debt, with only 20% of the adult population reporting to owe money, is low (chapter 4.2 – Regional comparison). However, further analyses reveal considerable differences between target groups, and between income levels. Table 19 demonstrates high levels of indebtedness amongst indebted people with low incomes, particularly low-income farmers and low-income MSME owners. With their low level of cash income and savings reserves (see chapter 5.2 – Current Usage), a significant part of indebted persons amongst the exposed groups will - within the short credit terms that are common in Laos - find it challenging to repay their debt out of their current cash income or liquid assets. Many will have to rely on debt restructuring or debt forgiveness, support from relatives or sale of assets[115].

Table 19 - Average monthly income, debt and debt/monthly income ratio per adult, by target group and by income quintiles

Target Groups	Average Monthly Income	Av. Debt	Debt/Monthly Income Ratio
Dependents	1,047,480	7,284,515	6.95
Informally employed	2,008,216	5,141,765	2.56
Low income farmers	333,803	15,197,478	45.53
High income farmers	2,022,414	13,551,360	6.70
Low income formal employees	1,098,580	18,179,082	16.55
High income formal employees	2,894,224	52,862,899	18.26
Low income non-farming self-employed (MSME)	757,368	27,820,949	36.73
High income non-farming self-employed (MSME)	4,025,875	49,872,677	12.39
Income Quintiles and Indebtedness	**Average Monthly Income**	**Av. Debt**	**Debt/Monthly Income Ratio**
Quintile 1	185,001	6,654,824	35.97
Quintile 2	465,678	18,087,305	38.84
Quintile 3	919,032	18,899,757	20.56
Quintile 4	1,680,657	18,506,154	11.01
Quintile 5	4,235,720	42,109,022	9.94

Debt capacity is low. Debt capacity is low in general, and in particular for the highly indebted low-income group that have little financial capability and a lack of robustness towards external shocks. With many government representatives encouraging people to take credit to finance business investments, and the increasing ease of borrowing for individuals with collateral, there are reports of overindebted individuals that have invested into failed activities and now are left with the headache of repaying their loans[116]. The large difference between mean and medium debt supports the assumption of a small number of persons holding large debt. Also the fact that disagreements over lending contracts have become the second-most frequent reason for legal disputes, indicates a growing number of cases of over-indebtedness[117].

Laos has experienced its first credit bubbles. Land titling and the increased price for land especially in urban areas, has enticed many people to take bank loans secured with their land. In a considerable number of cases, the loan revenue has been used to obtain a standard of living that was not supported by actual income, ending in default and voluntary or forced sale of collateral.

Subsidised lending causes overindebtedness. The Nayoby Bank's disbursement of relatively large loan amounts – from LAK 3 to 30 million per family – to poor farmers can be seen as a success, but it has undoubtedly created cases of overindebtedness, if the value of the loan is seen in relation to income and asset situation. According to FinScope results, the activities financed by these loans have not – at least not yet – translated into increased cash income.

Loan structure – scattered, expensive lending from informal sources – causes financial stress. During field work, interviewees[118] reported common use of leasing of household goods, trader credit for agricultural inputs and in-advance payments by some traders to a degree that it consumed the largest part of their lumpy income after harvest. Left without reserves, soon after harvest they would start again accumulating small-scale debt. Few of the farmers had substantial formal debt, so a restructuring of their debt combined with conscious liquidity management would save costs and improve the families' financial situation.

Use Cases and Credit Mechanisms

Lending for 'developmental purposes' occupies the largest share of credit purposes. The far biggest part of lending is done for 'development purposes'. The credit had either an immediate objective of increasing income, or a purpose related to the long-term asset building of the household: 55% of adults had taken a loan for one of the following purposes: education or school fees; buying a bicycle, motorcycle, car, pick-up truck or other transport; buying or building a dwelling to live in; improving or renovating a dwelling; buying a dwelling or land to rent out; buying land; buying farming equipment; buying farming expenses such as seeds or fertiliser; starting or expanding my business or business activities of the household; and putting money or goods into someone else's business. Another 17% borrowed to buy livestock.

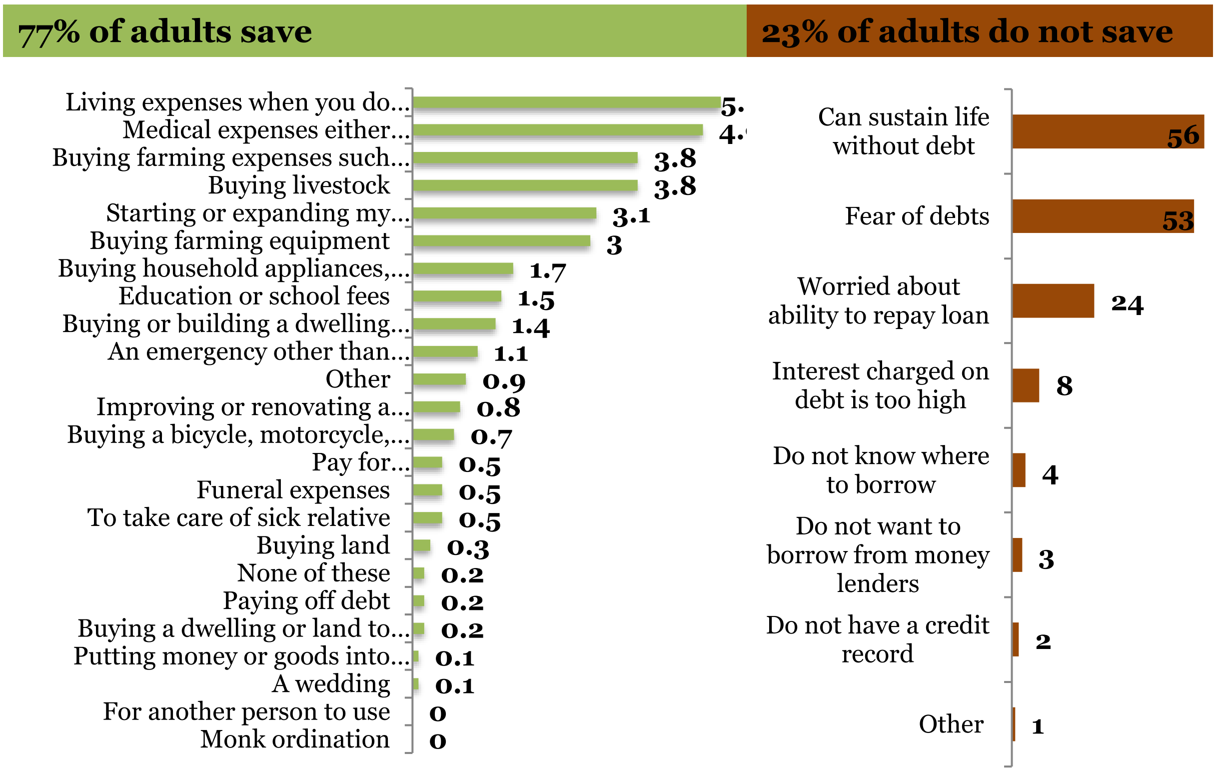


Figure 61 - Drivers and barriers for borrowing and credit

Livelihood credit to bridge liquidity gaps and to pre-finance emergency situations. Using debt to smoothen household consumption was mentioned by 25% as the main purpose for having a credit. 26% had borrowed money for a - mainly health-related (21%) - emergency situation.

In traditional farming systems, farmers pursue a low-risk investment strategy. Long-term horizons, low profitability and an intrinsic high-risk profile impede lending for agricultural activities. Upland farmers have relied on traditional slash-and-burn cultivation of sloping areas. Most farming households still produce mainly for their own subsistence, bringing only the surplus of their subsistence production to the market. In these settings, farmers employ a low-input strategy to keep risk at a low level. Only 8.3% of farmers borrowed for buying inputs to their production. They invest the surplus of labour – the most decisive input factor in indigenous farming systems and often the most limiting one – and other retained inputs, and use their savings for purchasing necessary inputs. The production is adapted to the household's labour resources, and expansions are done in small steps to limit their risk.

Agricultural development changes pattern of demand. Following massive infrastructure development and growing demand for agricultural products for domestic consumption and export, agricultural production is in fast transition. An increasing share of farmers is targeting their production towards the market, creating money flows and a new demand for financial services. In more intensive agricultural systems like in lowland paddy rice areas, the production risk is decreased, and production inputs and expansion are partly credit financed. In these settings, widespread lending for agricultural inputs and an unmet credit demand can be found.

Debt financing for consumption goods is low, but heavily underreported, when the widespread practice of leasing is taken into regard. In FinScope, 8% of adults said they had borrowed money for consumption goods like electric appliances, household goods or furniture. This is in sharp contrast to results from informal interviews, which revealed that buying household goods on lease is a very common practice.

Also the low level of borrowing from family and friends according to FinScope is in contrast to information from other sources. Either it has gone underreported, and/or indeed economic progress is decreasing the demand for such. The latter case can be supported by comparison between lending patterns in poor and better-off communities that reveals decreasing levels of necessity/livelihood lending.

Small and Medium Enterprises (SME) have high demand for credit. A GTZ survey[119] in 2009 found that 32% of the enterprises surveyed reported having borrowed from a financial institution. SMEs faced legal and capacity constraints in accessing credit, and these were strong impediments to SME development. Banks largely relied on use of fixed assets as collateral to secure loans, making it difficult for SMEs to obtain bank loans. Another critical constraint was limited credit information on customers that allowed banks to assess credit risk. Another constraint was the poor accounting and financial reporting practices of SMEs. According to the GTZ enterprise survey, about 60% of enterprises did not keep proper records.

Products and Providers

Similar to savings, the choice of product and provider of debt financing depends on the use case. Also with credit and leasing, we can develop a corresponding categorisation of use cases into different, although not clearly separated demand stages (Figure 62): subsistence demand, emerging market demand and commercial and wealth management demand related to increasing wealth and to increasing and more regular income.

	Subsistence Demand	Emerging Market Demand	Commercial and Wealth Management Demand
Use Cases	–Emergencies –Lifetime events –Offset of liquidity gaps	–Working capital for small, short-term enterprises with high return to capital	–Asset Building –Working capital and large investments
Characteristics	–Small amounts –Short runtimes –High fugitiveness –High-risk environment –High interest rate –Low debt capacity	–Increasing amounts –Short runtimes –High fugitiveness –High-risk environment –High interest rate –Increasing debt capacity	–Higher amounts –Medium to long runtimes –Determined money flow –Low or mitigated risk –Low interest rate –High debt capacity or –Collateral
Providers	Informal lending (moneylenders, trade credit)	Informal lending (moneylenders, trade credit)	P2B lending
	Village Development Funds, Village Banks	Village Development Funds, Village Banks	
		Formal MFIs	
			Banks, Policy Bank
			Leasing (Formal and Informal)
Products, channels	–Informal credit	–Informal credit –Trade credit –SME loan	–Informal credit –Credit line –Bank credit –Lease

Figure 62 - Credit use cases, providers and products *(Source: Own)*

The connection between provider and loan amounts, with banks providing the largest loans, is illustrated in Figure 63. It also shows that presently, banks are the largest providers of credit both in numbers and in credit volume.

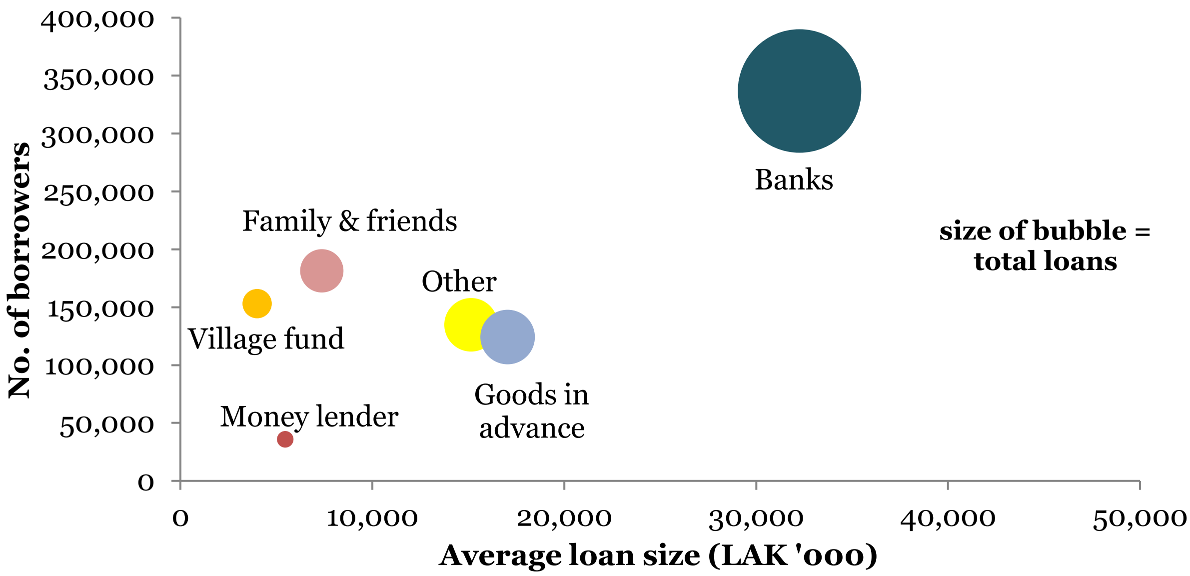


Figure 63 - Credit provision by type of institution, number of borrowers and average loan size[120]

NB: SCUs and MFIs omitted as no loan amounts were stated by the borrowers.

Subsistence and emerging demand mainly served by social network and informal credit providers. Financing in an insecure environment typically requires fast and easy access. Loans are mainly of short-term nature, and the credit amounts are relatively small. Because of the short time frame, the level of necessity and – in case of small business activities – the typically high return to invested capital -, the interest rate has low relevance.

Most Laotians will turn to their social network first, when in need. According to FinScope, 93% of adults can get money from their family when in need. 83% can get money from within their community. For this kind of situation, relatives and friends will be asked for a favour to lend money. Typically, no interest is charged[121], and repayment conditions are not fixed. In poor communities with low cash reserves, the village fund is cherished because 'one has access to cash when one needs it'.

The category of moneylenders is diverse, and so are their specific market niches. Even though private lending is on the retreat, as more advanced sources are emerging, they continue to provide for specific niches, including large amounts of money owned by wealthy individuals that are lent to business owners[122].

Village funds can cater for subsistence demand, but also for the investment demands of their members' small businesses. The traditional Rotating Savings and Credit Associations, in Laos called 'Lin Houai', once were a source of finance mainly used at market places, and is mainly associated with female members. Although still in use, they are crowded out by village funds and microfinance loans.

Formal institutions have difficulties in making a business case for credits that fit into the demand of the low-end segment. They can provide loans for business-related purposes, or for purposes where repayment is secured by collateral. Microfinance institutions are limited in their provision of larger loans, while banks' outreach to low-income clients depends on their lending policy and methodology. Bank lending is highly sensitive to the interest rate and the perceived profitability of the investment.

Many shops and traders provide sale on credit to a certain extent and to the limits of their own liquidity. Trader credits are widespread for short-term financing of agricultural inputs in intensifying annual crop systems, e.g. for fertiliser and pesticides.

Leasing – informal and formal - covers all wealth strata. Informal leasing of household goods, mainly by mobile Vietnamese traders is an old phenomenon. Travelling by motorbike, bicycle or by foot to even the most remote villages, they sell inexpensive household effects on lease. Leasing is also widely used by shops selling vehicles, machines and other high-value items.

Although formal leasing until recently mainly has been restricted to vehicles and machines, recently a number of foreign leasing have entered the motorbike and retail market in Laos. Within short time they have built a significant agent network.

Leasing is an attractive method of financing that has big advantages for both the provider and the client. For the lessor the problem of security is easier to resolve, because he retains ownership of the item. The lessee profits from payment schedules that fit better into usual cash-flow patterns, and also sees his risk limited to only losing the leased item and the payments made until default. For people that lack the financial discipline that is required to save for larger-value items, leasing can be a stairway to obtaining assets that they otherwise would not have been able to purchase.

Alternative finance systems: Contract farming has been introduced to Laos with the set-up of large-scale concessions and processing factories for agricultural commodities. There is no quantitative information on this financing mechanism, and it is not included in the analyses of this study.

Subsidised credit in policy priority areas and its implications. The Lao government wants farmers to abandon traditional slash and burn cultivation for subsistence and to adopt sedentary, market-oriented farming systems comprising cash crops, plantations and livestock. To make this change possible, multiple factors have to be put into place: crop cultivation technique, supply of inputs, marketing, veterinary services, and others. Access to credit is only one of them, and according to farmers' own perception, not a major one. Asked about the challenges they face as farmers, only a tiny fraction, - 2.5% - mentioned lack of funding.

Commercial credit is not viable until the broader development of rural areas has increased productivity and lowered the multiple risks of production and marketing. The government, together with a number of development organisations, have anticipated this perceived bottleneck by disbursing large amounts of subsidised credit with low interest rate and often conditional repayment conditions. Village revolving funds – monetary or in kind - have been a model preferred by many development organisations. The Nayoby Bank has become the major outlet for government credit, initially in the 72 districts identified as poverty priority areas, and since then also in other rural regions. Although an impact study never has been conducted, it is often assumed that credit schemes, together with the concerted development efforts, have been contributing positively to the economic development of most of these priority areas[123]. In the past, elite capture was common, as well as a very high default rate. Even though still a certain part of the subsidised loan portfolio of the Nayoby Bank is said to be disbursed to beneficiaries outside of its intended target group[124], it has a previously unseen penetration of the rural areas.

Successful or not, policy lending has a series of negative side effects that make it even harder for commercial players to enter the rural market. The gap between the higher cost level for services in rural areas and the artificially low interest rate level and the unsound client expectations and behaviour entailed has prevented other financial institutions from entering into areas with policy lending.

The cost of credit in Laos is high. Several factors determine, that the credit interest rate in Laos (Figure 64) is high by international comparison[125]. Laos fulfils most criteria listed in Table 20 that are leading to a high interest rate level. Compared to its neighbouring countries Thailand and Vietnam, the injection of subsidised loan capital has been at a lower level, and the central bank has so far been moderate in its attempts to curb interest rates. There is a considerable difference in interest rate between loans in the national currency and loans in foreign currencies, Thai Baht and US Dollars, which explains the high demand for credits in these currencies.

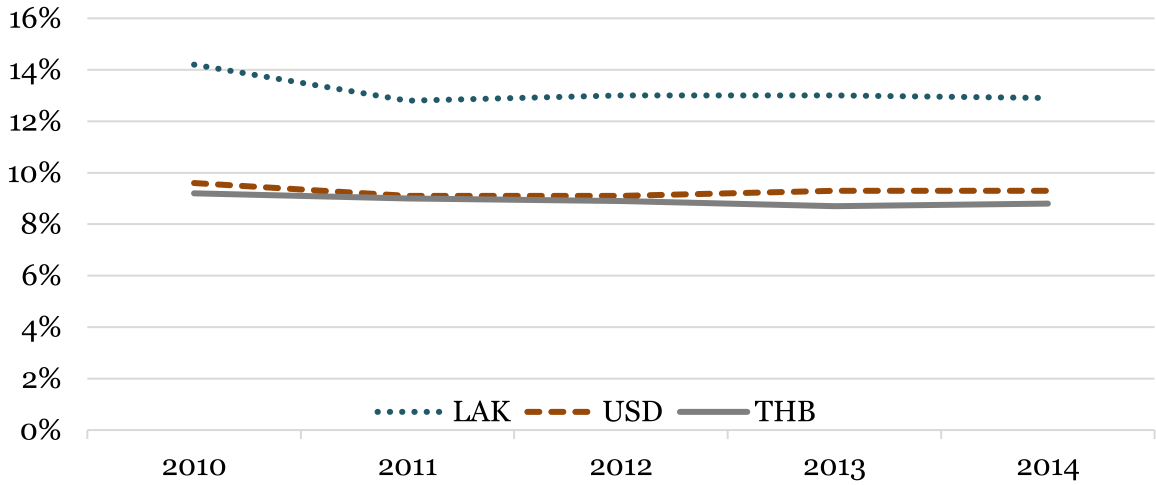


Figure 64 - Central Bank reference interest rate for 1-y bank credit in LAK, USD and THB *(Source: BoL, 2015)*

Table 20 - Interest rate determinants *(Source: own)*

Low-interest rate conditions	High-interest rate conditions
▪ Good infrastructure, high population density ▪ Large credit amounts ▪ Low production risk or risk mitigated ▪ Secured and enforceable collateral ▪ High debt capacity ▪ Strict contract conditions ▪ Efficient financial institutions ▪ Low inflation ▪ Savings/funding exceed credit demand	▪ Poor infrastructure, low population density ▪ Small credit amounts ▪ High, not mitigated risk conditions ▪ No collateral, or difficult to enforce ▪ Low debt capacity ▪ Flexibility in response to critical conditions ▪ Financial institutions operate inefficiently ▪ High inflation ▪ Credit demand exceeds savings/available funds

Formal credit is based on collateral, mainly land titles. Most financial institutions base their credit assessment on collateral rather than on income or the client's financial ability. The standard collateral used the most is land titles[126]. This practice excludes people without pledgeable collateral from formal lending, and has led to loan defaults and sale of the collateral for borrowers whose income was too low to repay the loan. Some microfinance institutions have successfully introduced alternative collateral, like payroll accounts or social collateral.

The use of flat rate lending127 is increasingly common amongst microfinance institutions. Flat rate lending has become increasingly popular especially amongst microfinance institutions. Few clients are able to distinguish between nominal and effective rate of interest, which – compared to the standard bullet repayment method - can double the nominal interest rate for credits with instalment schemes.

Long-term finance is not available. Mainly because of the high interest rate, and the high financial insecurity, long-term financing for items or activities with a long life-span is not available. The maximum loan term for bank lending is generally 5 years. Accordingly, only 2% of adults report to have borrowed to finance their present dwelling[128].

A comparison between different credit products (Table 21) reveals large differences. The direct costs of credit are lowest for bank loans. Village funds' interest rates differ widely depending on the level of economic activity in the village. Clients preferring more expensive microfinance and informal loans often do so because of indirect costs caused by transport and time spent for application. An important factor deterring eligible customers from applying for a bank loan are banks' image compared to people's self-image. The Laotian banking sector's rooting in the government rather than in the private service sector has contributed to ordinary peoples' ('Pasason') fearful attitude in regard to banks. For FinScope respondents, 'Image' is the single most important factor in their choice of financial provider. Supported by the results from all informal client interviews, this image mismatch is possibly the largest impediment for banks in achieving depth.

Table 21 - Pricing of reference credit and quasi-credit products *(Source: Providers)*

	Bank Loan 1 year (APB)	Bank Loan 1 year (ACLEDA)	SME loan 1 year (EMI)	MF loan 1 year (Champa Lao)	Village Fund 1 year	Trader credit 6 month	Leasing
Processing fees[129]	Application form LAK 50,000, Evaluation fee LAK 300,000 – 1 mio.	Preparation fee LAK 50,000 – 1.5 mio. dep. On loan size	Loan Book LAK 5,000. Admin fee LAK 20,000 – 500,000 dep. on loan size	Loan fee LAK 20,000-150,000 dep. On loan size	0-10,000	0	
Collateral	yes	yes	yes	yes	yes/no	no	n/a
Annual interest rate (nominal)	14-16% (Declining)	17-19% (Declining)	72-84% (3.5% per month Flat Rate [130])	72% (3% per month Flat Rate)	6-48%	20-80% (3.5-13% per month Flat Rate)	24-30% (2-2.5% per month Flat Rate)
Other costs	Administration fee 0,5-1%	Administration fee 1-2%	none	none	none	none	
Typical annual costs in % (example LAK 10 mio.)	21.5%	21.0%	84.5%	72.5%	36%	50%	

Regulatory Issues

Only few regulatory restrictions limiting credit provision exist in Laos. Most of the regulations that effect credit availability are rooted in the central bank's attempt to ensure prudent banking practices - loan/deposit ratios, loan/collateral ratios, the requirement of foreign currency income for borrowers of foreign currency credit - and are as such justified. However, the regulations are not consistently applied or enforced.

Indirect cap on lending interest rates. Until recently, there was no absolute cap on credit interest rates. However, banks' interest rates on credit are not to exceed rates for savings deposits with the same maturity by more than 5%. With the recent introduction of deposit rate caps there is now also an indirect, absolute cap on credit interest. Such a limitation has a negative effect on banks with a microlending agenda, as they may not be able to cover their costs of servicing marginalised clients. However, the regulation only concerns nominal interest rates, leaving the possibility to circumvent these limitation by using flat rate interest rates.

No requirements concerning product information. Financial institutions are presently not required to inform their clients in a standardised way to make the market more transparent. Thus, it is extremely difficult for clients to 'shop' for the most favourable product.

Gaps and Opportunities

A strong political fraction within the government wants to see lower credit interest rates. The perception of the need for low-interest credit in large parts of the government has been discussed before. There is little understanding for the requirements and the advantages of a market-based financial system, and a tendency to direct socio-economic development rather than to facilitate it. The extension of subsidised credit to perceived priority areas is one of the results of this strategy. Political pressure is exerted on the sector and its supervisor, the central bank. As seen with the introduction of a deposit rate cap, this can lead to market-distorting practices, whose consequences are little understood and difficult to anticipate. Non-governmental multi-lateral or international organisations may be able to enter into a dialogue with the strategical wing in order to raise awareness about the negative consequences of market distortion, and to present alternative solutions.

Subsidised lending has negative side effects. According to FinScope, the policy to provide credit to poor rural residents has been successful. Farmers and other rural residents have a similar use of credit as other groups. However, this has led to an unsustainable level of debt for many, and especially poor borrowers. Commercial service providers have been crowded out. Affected clients have adopted unrealistic expectations towards the conditions of viable credit. Additional to the inherent challenges to provide services to low-income and remote clients, competition with a subsidised system makes it even harder for commercial institutions to expand their outreach. Advising the government in redirecting and – in the long term – reducing its subsidies, and in providing incentives for non-state providers to take over the business of lending may give positive results.

It is difficult to assess the actual demand for credit. FinScope results can lead to the conclusion that demand for credit in Laos is very low – not a single respondent mentioned 'no one to borrow from' as a reason for not borrowing. However, in fact, people do borrow, and, during qualitative research, interviewed groups expressed different levels of demand for credit. Clients are usually very conscious about the conditions for a credit, mainly the interest rate and whether loan terms are handled flexibly in case of repayment difficulties. In a small survey amongst 63 rice farmers in Southern Laos[131], their demand for credit was investigated with three different interest rate scenarios (Table 22). The demand increased more than 20-fold from the high-interest to the low-interest scenario, highlighting the sensitivity of demand to credit conditions.

Table 22 - Interest rate and credit demand[132] *(Source: SNV - Netherlands Development Organization, 2012)*

Monthly Interest Rate (%)	1%	3%	5%
No. of respondents would take loan	44	10	3
Average credit amount (LAK)	5,193,000	6,650,000	3,666,000
Total credit amount (LAK)	228,500,000	66,500,000	11,000,000

Many people's genuine lack of planning and management skills add to the difficulty to assess credit demand. Also the lack of projects that would qualify for sound lending was mentioned as an impediment during discussions with both providers and clients. Qualitative research[133] also gave a strong indication that demand is developing alongside supply. Two pairs of villages in Oudomxai and Champassak provinces with comparable situations, but with different exposure to financial services, had widely different levels of demand, with the less exposed villages having less demand.

Poor people are too shy to use bank services. As mentioned before (chapters 5.2 –Products and Providers and 5.3 - Products and Providers), common people are reluctant to approach banks for services. Even though many of them actually may be eligible for bank credit, they feel shy and unable to deal with the formalities. If banks can bridge the mental distance, by adapting their procedures or with the help of external facilitation[134], they are able to reach this segment.

Financial institutions report high demand for SME lending. Small and Medium Enterprises have difficulties to satisfy their capital demand. As many of them cannot meet banks' requirements for collateral, and banks have difficulties to meet SMEs' demand for punctual and unbureaucratic issuing of loans, they have to a high degree to rely on informal services. Some microfinance institutions have successfully specialised in SME lending by adapting their methodology. Leasing of vehicles and inventory fits well into the demand of owners of small enterprises. An extension of the range of collateral that legally can be pledged to include stock and other moveable assets will also improve SMEs' access to formal credit.

Credit products do not fit into poor clients' needs. Credit business in Laos is very traditional with little innovation and few attempts to develop new products that fit better into the requirements of poor people. Traditionally, village funds, most microfinance institutions and banks offer similar standard types of short-term loans with land as preferred collateral and balloon repayment at the end of the loan term. Each of these features can be challenging to comply with for clients with a low resource base. Providers, who are successful in SME lending, use alternative collateral, instalment schemes that fit into the client's cash-flow, and streamline their application processes.

Many businesses have constant credit need for financing of working capital, or need to finance long-term investments. Low-interest credit is crucial for certain long-term, low-profit investments, but can under present market conditions not be commercially provided. Credit lines/overdrafts/revolving credits are available from banks, but underused.

Village funds can be good providers of microloans. Besides mobilising petty savings from formerly unconnected people, well-functioning village funds are well-suited to provide small loans with relaxed conditions compared to formal credit. If the credit committee applies sound credit policies, village funds can absorb the demand of unbanked clients and educate them to comply with formal credit.

General lack of skills to manage credit. The generally low level of financial skills also affects peoples' capability to make good decisions concerning the use of credit. An increasing level of formal education, growing experience with the financial system and – possibly – specific measures to enhance peoples' financial capabilities are expected to have a positive effect on their capability to use credit as a tool to improve their economic situation. In the short and medium term, financial institutions themselves can take over responsibility to educate their clients[135]. The provision of sound practices in the financial sector, especially sound client assessment, products that fit into poor clients' financial situation, qualified client guidance and a firm loan delinquency policy that is adapted to customers' actual situation also have a highly educational effect.

Credit and financial skills must grow alongside each other. The observed credit aversion – people stating their fear of getting indebted – is the expression of a sound awareness of the risks inherent to credit and self-awareness of one's own limited capacity to manage this risk. The provision of credit alone, without accompanying measures to enable to use the credit to their own benefit, can turn out to have negative impact on people's livelihood. Government, financial service providers or project representatives should not attempt to push people into debt that is exceeding their capacity to manage and repay it.

5.4 Payments and Remittances

Current Usage

Payments and remittances. The term remittances is used here for the practice of sending money over distances, physically as cash or electronically by using a financial payment service. The term payments refers in this context to any act of financial transaction involving the use of money.

The economy in Laos is predominantly cash-based. The payments environment in Laos can be characterised by the fact that nearly all retail payments are made in cash, between private persons, customers and businesses alike. Less than 1% of adults report to have paid bills other than by cash[136]. Only a small portion are made via domestic inter-bank transfers and even in these cases payments are mostly over the counter: deposited by the sender in cash and withdrawn by the receiver in cash.

Lao people predominantly remit through the formal sector. 35% of adults in Laos have remitted within the last 12 months (Figure 65). There is a clear preference for formal channels – banks and the postal service. More than half of people (56%) either sending or receiving money had several transactions per year, about one in four (23%) remitted monthly and one in six (15%) remitted once per year.

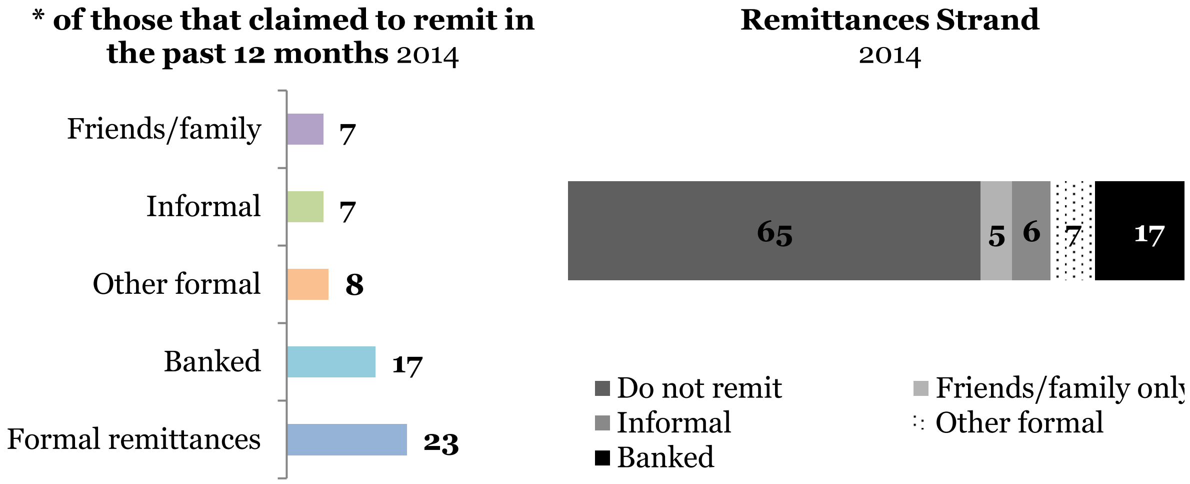


Figure 65 - Remittances access strand

Domestic remittances dominate, accounting for 71% of all remittances. The majority of international remittances are receiving transactions (Figure 66).

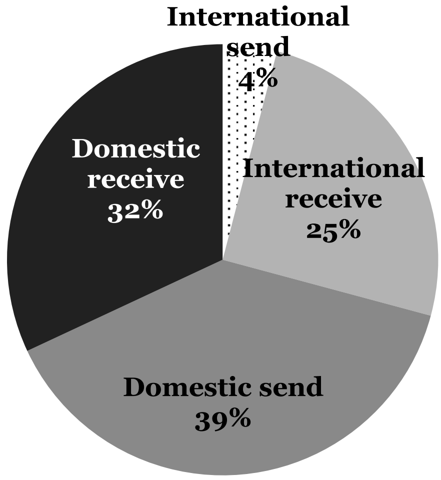


Figure 66 - Remittances - international and domestic

Urban and rural areas are remitting equally. The share of rural and urban remitters corresponds closely with their share of the population, with urban dwellers remitting slightly more than rural (Figure 67).

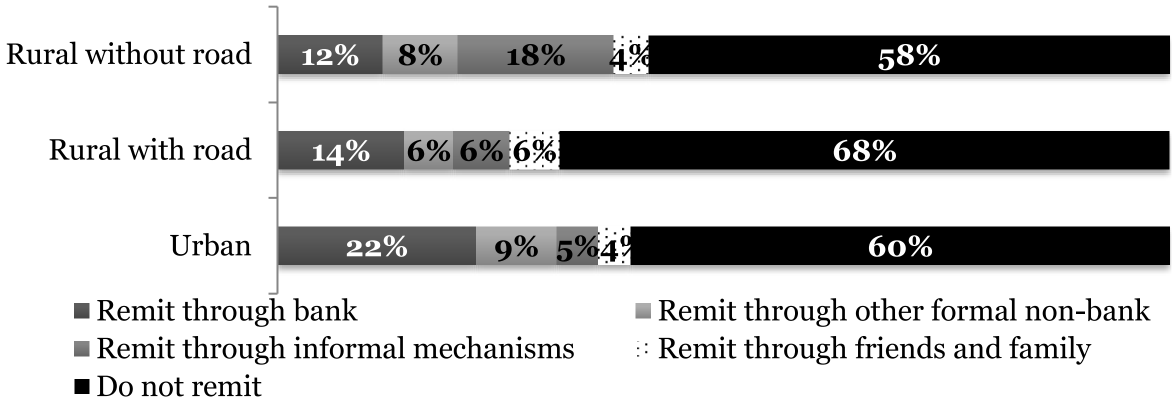


Figure 67 - Use of remittances and location

Remittances reveal migration patterns. As most retail remittances are made to bridge a distance between the place of income and the place of consumption, by looking more closely at regional differences (Table 23), we can trace patterns of temporary migration for work. Vientiane accounts for the highest share of remittances to other countries, while the South and Central regions are the main receivers – a true picture of the migration pattern from these regions to neighbouring Thailand. For domestic remittances, it is striking that the Northern region (in number of remittances) is sending more than it receives, while the South receives more than it sends.

Table 23 - Regional remittance patterns

	Share of population	International / Domestic	Send	Receive	Send	Receive
Vientiane Capital	13.1%	International	38,471	79,608	48.5%	16.3%
		Domestic	114,094	84,063	15.1%	13.5%
North	31.8%	International	15,062	36,890	19.0%	7.5%
		Domestic	252,733	137,227	33.4%	22.0%
Central	34%	International	13,928	196,664	17.6%	40.2%
		Domestic	256,756	226,846	33.9%	36.4%
South	21%	International	11,782	176,241	14.9%	36.0%
		Domestic	133,938	174,530	17.7%	28.0%
Total	**100%**	**International**	**79,242**	**489,403**	**100%**	**100%**
		Domestic	**757,521**	**622,666**	**100%**	**100%**

A higher share of girls and women are using remittance services (Figure 68), most likely because of the higher share of females amongst dependents (tertiary students and elderly).

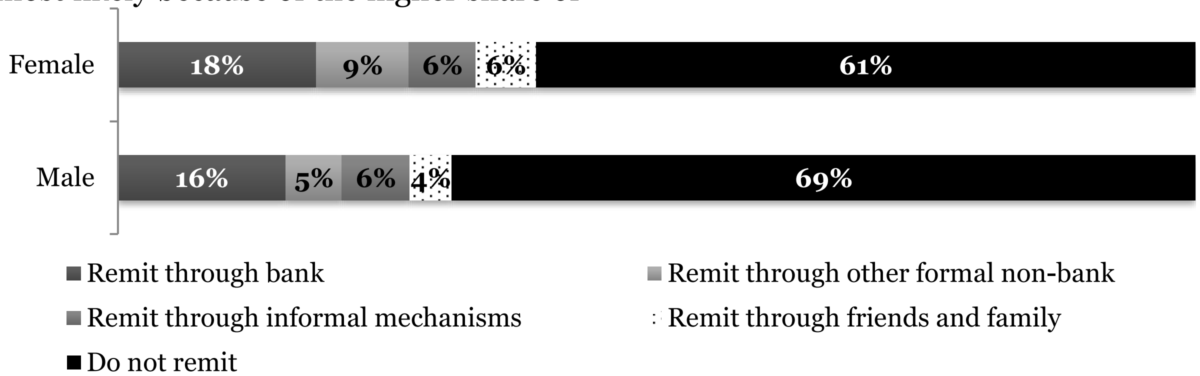


Figure 68 - Use of remittances and gender

In contrast to the other financial products, payment services are more used by young, and elder persons (Figure 69). The age category 25 – 45 years is remitting the least.

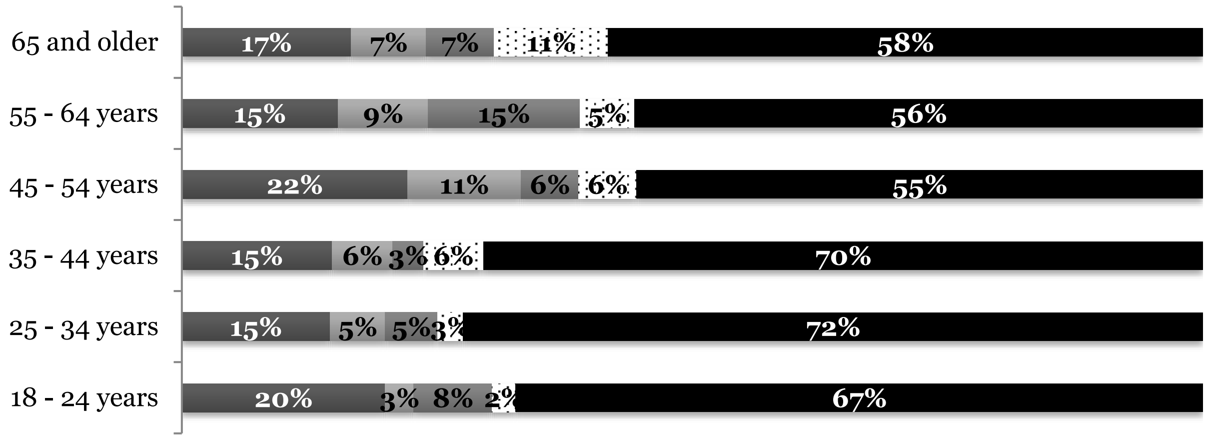


Figure 69 - Use of remittances and age

The use of remittances increases with the level of education (Figure 70).

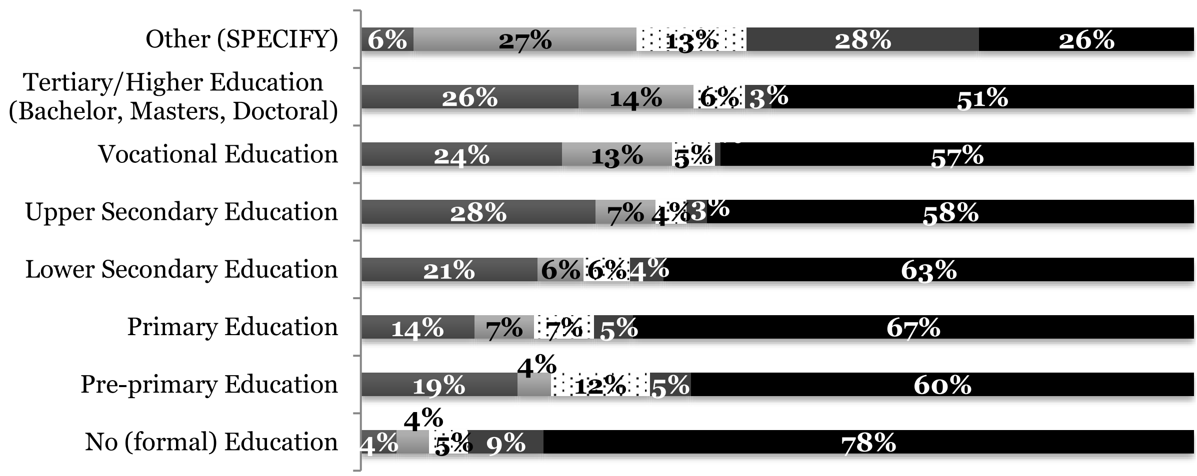


Figure 70 - Use of remittances and education

Amongst target groups, dependents and high-income groups remit most. It comes not as a surprise that the target group receiving its main income from support is the group with the highest use of remittance services (Figure 71). Formal employees and non-farm self-employed people are the groups using formal remittance channels the most.

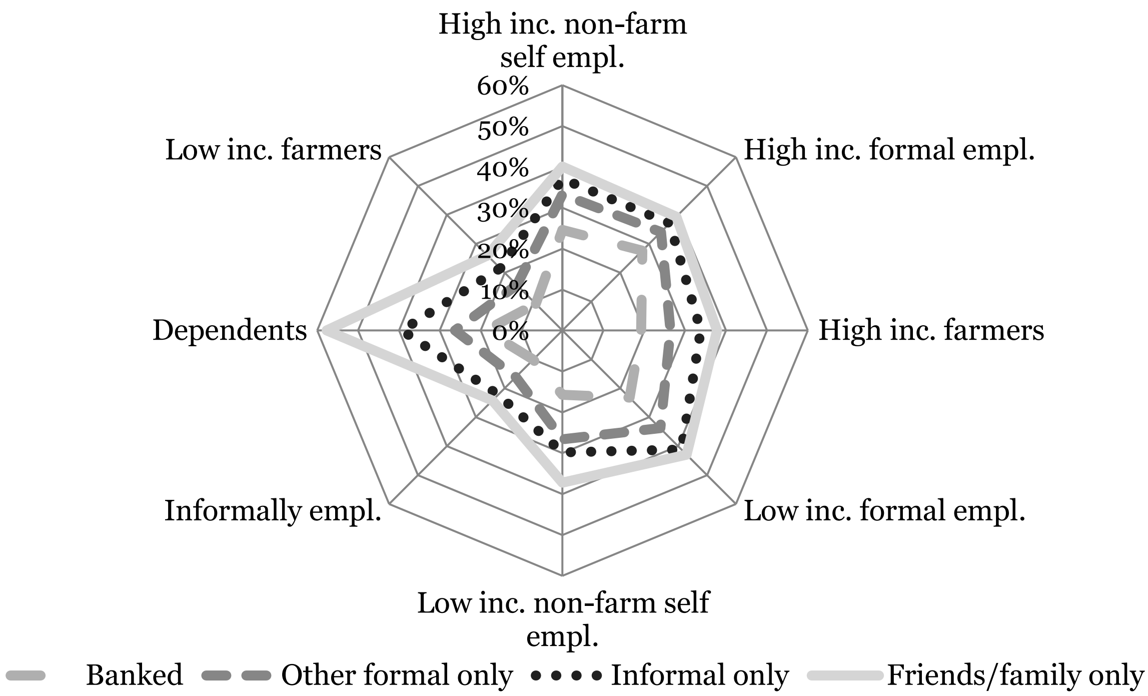


Figure 71 - Remittance access strand by target groups *(Source: FinScope, 2014)*

Use Cases and Mechanisms

Payments and remittances. Most retail remittances are made to bridge a distance between the place of income and the place of consumption. Members of the family working at distant locations, parents supporting their children's higher education and children providing support to their elderly or work-incapacitated relatives are the main use cases for remittances. Payments also include the settlement of outstanding liabilities like the employer's paying salary, payment of utility bills or payment for other goods and services.

Support from relatives abroad. In the decades after 1975, many families received financial support from relatives that had fled the country because of their affiliation to the old system.

Lao migrant workers abroad and at home. Laos has several hundreds of thousands of migrant workers working abroad, an estimated 300,000 - almost 10% of its 3,445 mio. workforce - of them, mainly from central and Southern Laos, working in neighbouring Thailand[137]. Also the amount of domestic migrant workers is large and increasing, mostly as construction and factory workers. Many of them are recruited amongst the 'rural poor', many of them traveling from the Northern part to the greater Vientiane area for employment.

Foreign nationals working and residing in Laos. Many foreign nationals are working in Laos, the main part coming from China and Vietnam. These aliens are not consistently included in statistics or surveys, including the FinScope survey. Official sources state a number of 50.000+ foreign workers[138], unofficial estimates are far higher, up to 10 times the official amount. This category consists of persons with widely differing affiliation to Laos: Business owners that have resided in Laos for many years or decades, craftsmen without permanent residence in Laos, foreign companies' representatives, but the main part are skilled and unskilled labour that are hired by the above, the majority without work permit.

Transfer for education. The same trend is valid for the increasing number of parents that support their offspring's tertiary education often away from their home, and even abroad.

Old age support. Many elder depend on the support from their children. When the children live far from their parents, such support may imply remittance.

Payroll transfers. With the exception of government employees working in very remote areas without access to remittance services, all government staff are paid by transfer into their bank account. Many large factories do payroll payments into the accounts of their staff that can withdraw their salaries from ATMs often strategically placed in proximity of the factory[139].

Use cases avoiding formal services. There are also use cases preventing people from using formal payment and remittance services, especially when people are practicing illegal activities. With the available information it is not possible to estimate the extent of informal transactions that are made to avoid taxation, for money laundering or to send income that is earned by illegal migrants.

Products and Providers

Postal Services for domestic remittances have been partly replaced by banks. The Lao postal service ('Entreprise des Postes Lao'), has been the traditional channel for domestic remittances due to its network in all districts and due to the relative convenience and low costs of transferring money via the postal network. It is still widely used, but with the growing network of branches and ATM, and the increasing range of attractive payment products, banks have increased their market share, and now dominate the payment market (Table 24).

Table 24 - Payment providers by market share

	Bank transfer	Post office	Western Union	Money gram	Friends or family	Informal agent	Mobile phone / mobile	Bus (driver)	Motorcycle	Other	All channels
SEND											
Domestic	49%	18%	2%	<1%	20%	<1%	<1%	8%	1%	<1%	100%
Abroad	49%	3%	25%	5%	13%	<1%	<1%	<1%	<1%	6%	100%
RECEIVE											
Domestic	41%	18%	3%	2%	21%	3%	<1%	6%	4%	3%	100%
Abroad	39%	13%	7%	5%	5%	29%	<1%	<1%	<1%	2%	100%

Use of money transfer providers when receiving transfers from relatives overseas. Since the end of the 1980s, many families with relatives abroad have received remittances via Western Union or Money Gram, the two global remittance firms operating in Laos that have built an extensive network of agents and subagents. With the progression of generations and the increasing wealth in Laos, this support has declined significantly and, with the development of the payment system and increased use of bank accounts, the use of money transfer companies is increasingly being replaced by international interbank transfers.

To remit money via the formal sector is standard practice, except in cases of convenience - e.g. a family member that travels into the same direction - , or in case formal channels are inaccessible. A large share of Lao workers in Thailand is working without working permit and without paying taxes, and consequently will not use formal transfer channels to remit money to Laos. 80% of remittances from Thailand are estimated to go through informal channels, either by carrying personally or sending cash with entrusted persons, or remitting via persons or private networks with bank connections in both countries[140].

Payment of bills. An increasing number of public service providers, including water and electricity supply, offer settlement of bills via bank transfer (over the counter, from account to account, per ATMs and web applications for computers and smartphones).

The use of formal providers is preferred for remitting, but cash remains the dominant payment mode. Compared to the savings and credit strands, Laotians have a preference for remitting with formal institutions. For non-remittance payments, even though formal money transfer products are easily accessible, secure and competitively priced (Table 25), many people hang onto their traditional cash-based channels, because of a certain reluctance towards formal processes, and lack of experience of non-cash transactions.

Table 25 - Pricing of reference remittance products *(Source: Providers)*

	Domestic			Trans-border		
	Remittance – BCEL	Remittance – post OTC	Remittance – family/friends	Remittance - bank	Remittance WU OTC	Remittance – informal
Cost to send	LAK 10,000 to other province. LAK 15,000 to other banks and to receivers without bank accounts	LAK 9,000 for amount LAK 100,000 -> LAK 104,000 for amount LAK 10 mio. (9%->1%)	'cost of water'	0.1%, min. USD 5 max. USD 700	min. USD 15 -> USD 601 for amount USD 15,000 (>15%->4%)	3%
Cost to receive	none	none	none	0.1%, min. USD 5, max. USD 500	none	None

Digital Finance in Laos is in its initial steps. A previous attempt in 2011-12 by Lao Telecom, the country's largest mobile provider to launch an SMS-based payment product (M-Money) failed amongst other reasons because of the underestimation of the challenges of handling cash. Since then, the only mobile phone-based products available were browser-based web banking applications and apps for smartphones that are standard products at all major banks, and used mainly by a small group of upmarket clients. Several new attempts to introduce new products based on mobile technology are under preparation though. BCEL is piloting a mobile solution implying the use of local agents since June 2015, and ETL's 'E-wallet' is expected to be launched later this year.

Mobile coverage is good and improving. 71% of adults are using a mobile phone. The phones are mainly used for making and receiving calls. The use of SMS (5.6%) and internet (4.3%) is limited, and the online banking applications available are virtually not used (0.01%).

Regulatory Issues

The legal framework for the National Payment System and for Digital Finance is still under construction. The Bank of Lao has adopted a strategy for the development of its National Payment System and is intensely interested in promoting digital financial services. As both areas are under fast development, it is challenging for the legislator to find a satisfactory point of reference. A number of processes are regulated on an interim basis by low-level documents, many of them not publicly available. Initiatives that are not covered by present legislation, are governed case by case with the purpose to provide experience for a mutual learning process. Although this situation has the potential to foster insecurity and considerable confusion amongst providers and clients, it may be difficult to resolve in the short term. The lack of a solid regulatory foundation is therefore seen as a secondary issue, not a primary cause reflecting negatively on payment services.

Gaps and Opportunities

Remittances services have large potential to give previously unbanked people their first encounter with the formal financial system. Poor peoples' need to send money over distances is already now a main driver for financial inclusion. The relatively high level of usage of formal remittance services in rural areas indicates that people already use them according to their needs. Compared to informal arrangements, the use of formal payment services is often cheaper and faster. With high and growing mobility for work and education this trend is unlikely to change.

The payment system in Laos is in its early stages, but it is expected to develop rapidly. The electronic infrastructure development for real time settlement of interbank payments should be a priority area. Better use of the already existing Real Time Gross Settlement (RTGS) system and the set-up of an Automated Clearing House (ACH) system will pay off in the longer term. Also the development of real time retail payment processing platforms will be a long-term investment. However, the low volume of non-cash transactions is in itself presently a major impediment for increased use that will reflect negatively on the economic viability of such investments. The lack of cooperation between banks makes it even more difficult to achieve economy of scales.

However, the effect of alone-standing payments on the financial system on micro and macro level should not be overestimated as long as they are just casual and mainly made counter-to-counter. Such payments may save costs for sender and receiver, but they do not themselves result in other potential benefits. First when accounts are established in combination with, e.g. a payroll or regular support payments, these accounts have the potential to retain money that otherwise would be kept as cash with all its risks for the owner and its disadvantages.

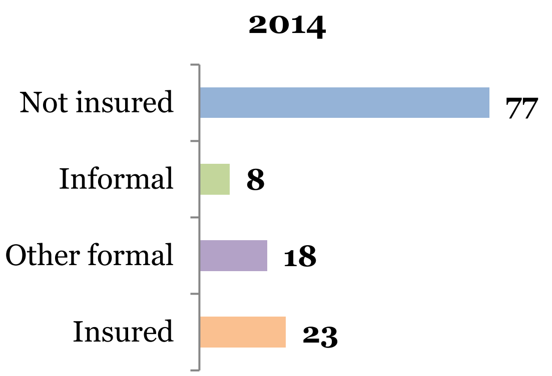
Widespread cash preference is a major impediment for further development of the retail payment sector. The relatively good availability of cost-efficient payment services and the already widespread use of remittance services lead to the assumption that increased use of payment services can be achieved mainly by stimulating demand. It appears that Lao citizens' cash preference is guided by customs and attitude rather than by necessity. Under all circumstances, it will take time to overcome this obstacle. Information campaigns about the advantages of using electronic money may create awareness and trust. The Lao government is already directing its payments through the banking sector as much as possible. Further encouragements to larger companies to make use of the payment system instead of paying in cash would have a beneficial effect.

However, the emergence of new, convenient and cost-efficient products can boost demand. The development of new distribution channels has large potential, but its success is difficult to predict. The rapid development of the ATM network in Laos has been successful; although ATM users are mainly amongst upmarket clients, also low-income employees have been targeted successfully. New distribution channels e.g. using mobile phones and local agents can extend the range of the payment network considerably saving costs for both providers and clients.

5.5 Insurance

Current Usage

Very few people mention use of insurance schemes as mechanism to mitigate risk. Less than one in four Lao adults reported the use of an insurance product (Figure 72).



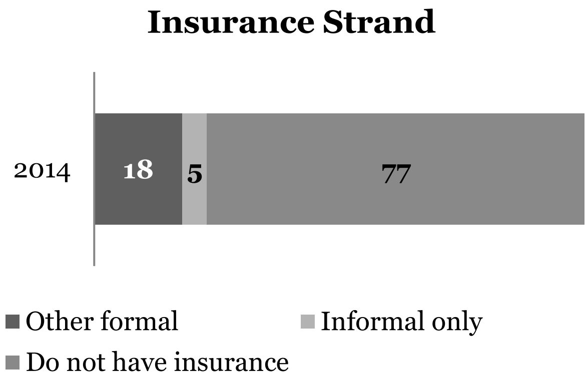


Figure 72 - Insurance access strand

Almost a third of the population is covered by national health insurance, but many are not aware. According to the National Health Insurance Office, 29,8% of the population is presently covered by a public health insurance scheme; however, obviously a large part of them is not even aware of that, or do not see their coverage as valuable, as less than 10% (9,66%) of the FinScope respondents mentioned to have a (private or public) health insurance.

Use is higher in urban areas. In urban areas, with their higher density of vehicles and more police enforcement of compulsory documentation and insurance, the share of people with insurance products is significantly higher (Figure 73).

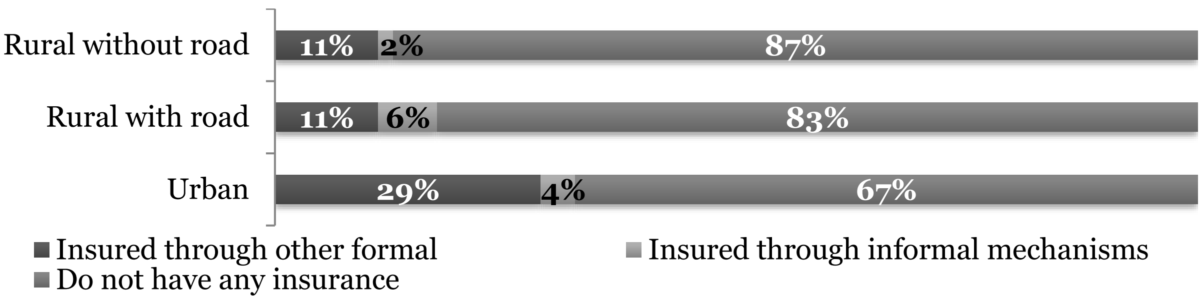


Figure 73 - Location and use of insurance products

Age differences in use of insurance are small (Figure 74), but reveal the use of burial societies by the elder generation. The use of formal insurance differs very little between age categories, while the use of informal services is more widespread with increasing age. These informal services are mainly village-based burial societies that have tradition in Buddhist communities.

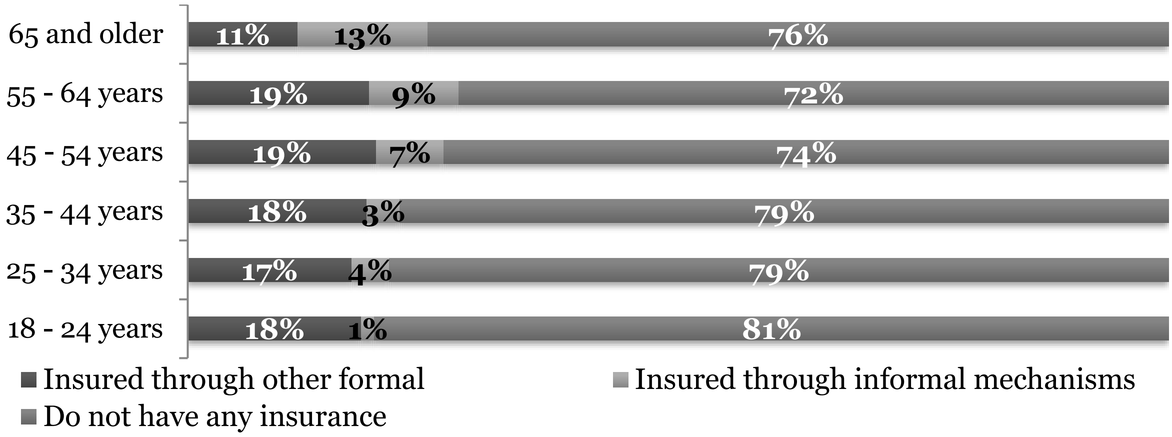


Figure 74 - Age and use of insurance products

The correlation between education and use of insurance products is very high. The use of formal insurance by highly educated people is nine-fold the use by people without formal education because of better awareness and the effects of higher and more regular income (Figure 75).

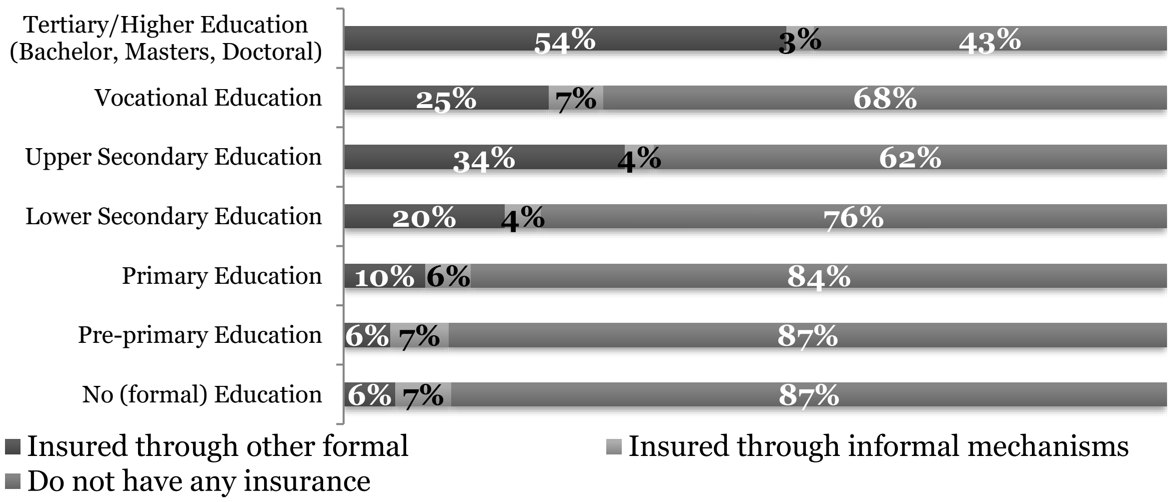


Figure 75 - Education and use of insurance

There is a clear distinction between target groups concerning the use of insurance products (Figure 76). Formally employed and high-income non-farm self-employed people use insurance services distinctly more than farmers, dependents and informally employed persons, caused by the former's connection to a more formalised and urban context.

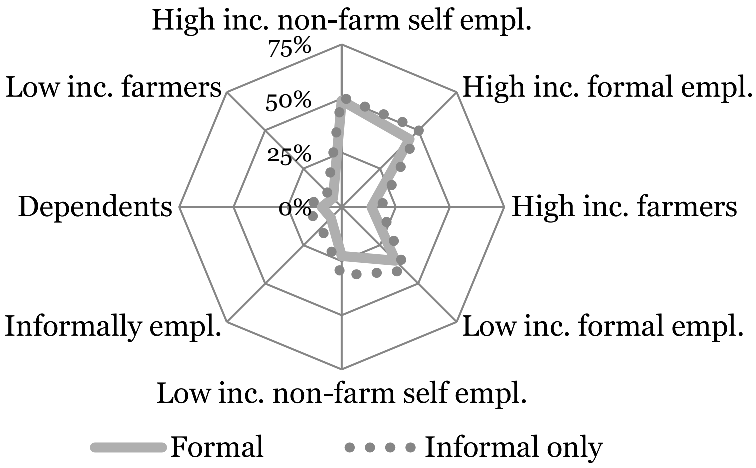


Figure 76 - Target groups and use of insurance products

Use Cases and Insurance Mechanisms

Insurance is a proactive mechanism for risk mitigation. Insurance is a financial product specifically designed to make up for future losses caused by unpredictable and uncontrollable events, hereby mitigating the risk of negative impact such events may cause to the affected entity. Also other financial products can be used for risk mitigation.

Dealing with risk dominates poor peoples' economic decisions. The poor are particularly vulnerable to suddenly occurring shocks that influence their fragile income situation or imply large expenses, like the death of a family member, severe illness, or loss of crops, livestock or housing. Poor households have a lower risk capacity then wealthier ones, and reducing risk is a paramount objective for the households' decisions.

FinScope asked which types of shocks the respondent had experienced within the last 12 months, and how he/she and his/her family had responded to the shock (Table 26).

Illness, increase of household size and shocks from agricultural production and market risks were the main shocks experienced. Socially related events were mainly dealt with by using savings, while income-related shocks either made the family sell some assets or cut down on expenses. The most used reply though was 'Did nothing', which either indicates that the shock was too small to seriously affect the family, or is an expression of fatalism. Use of insurance for these kind of shocks was virtually nil.

Table 26 - Shocks and coping mechanisms

	Frequency of event	Claimed Insurance	Used savings	Borrowed money	Sold something to get	Cut down expenses	Did nothing	Other
Increase in household size	11%	0%	62%	7%	8%	6%	7%	8%
Death of or loss of income from main income earner	1%	0%	51%	0%	1%	1%	28%	19%
Death of other family member not main income earner	3%	0%	46%	16%	9%	1%	21%	7%
Illness within your family that requires medical expenses	18%	3%	62%	11%	18%	2%	2%	3%
Separation or divorce	1%	0%	23%	0%	10%	4%	42%	22%
Disability - self or household member	1%	3%	21%	5%	12%	0%	48%	12%
Having to pay unforeseen school/education fees	5%	0%	65%	14%	9%	8%	1%	3%
Loss of job - self or household member	1%	6%	24%	0%	0%	36%	34%	0%
Fire or destruction of household property	1%	0%	16%	6%	4%	0%	60%	14%
Loss of your home	0%	0%	0%	71%	0%	0%	29%	0%
Loss of your savings	1%	0%	6%	0%	10%	6%	78%	0%
Drought, poor rainfall or loss of access to water	12%	3%	12%	1%	19%	13%	44%	8%
Flooding / storms	8%	0%	9%	4%	23%	9%	42%	13%
Harvest failure or losses of crop harvest	10%	0%	19%	3%	23%	4%	39%	11%
Death or illness of livestock	10%	0%	8%	0%	17%	3%	59%	12%
Loss of your land or access to land you use	1%	0%	15%	0%	0%	43%	42%	0%
Low selling prices	7%	0%	8%	2%	9%	35%	43%	3%
Oversupply makes sale difficult	3%	0%	10%	7%	11%	47%	23%	2%
Loss/failure of your business	0%	0%	0%	57%	0%	43%	0%	0%
Rise in prices of goods and services	6%	2%	28%	2%	8%	29%	29%	2%

Health expenditures are an important factor for financial behaviour. FinScope shows clearly what a major issue health care is for many families in Laos. Medical expenses are the main incentive for people to save, and also a good deal of borrowing is related to medical emergencies. 70% of Laotians feel that they have health issues and 26% of respondents have experienced situations of illness that had to go untreated. Again and again, informal interviews tell stories of families that get impoverished because of one family member's illness that makes the family spend large amounts of money when desperately looking for a cure at different places, ghost healers, public hospitals, private clinics and finally in Thailand. Although, as mentioned before, 30% of the population has public health insurance, only 10% mentioned it. Procurement for health expenditures was stated as major reason for saving and for using credit.

Old age provision. The effect of old age on one's own ability to provide for one's life is another use case for insurance. A part of employed persons, and all government employees, are covered by compulsory public social insurance schemes. Pensions, though, are generally too small to be sufficient. The traditional obligation to take care of one's parents, once they become dependent, is still strong in Laos. Most people mention a buffer of savings or assets as the main mechanism they plan to rely on during old age (Figure 77). However, only 16% of adults actually mention old-age provision as a reason for saving (see chapter 5.2 – Use Cases and Savings Mechanisms); either intentions to save for old age are not actively followed up in reality, or a gap in financial service provision for this purpose prevents people from doing so.

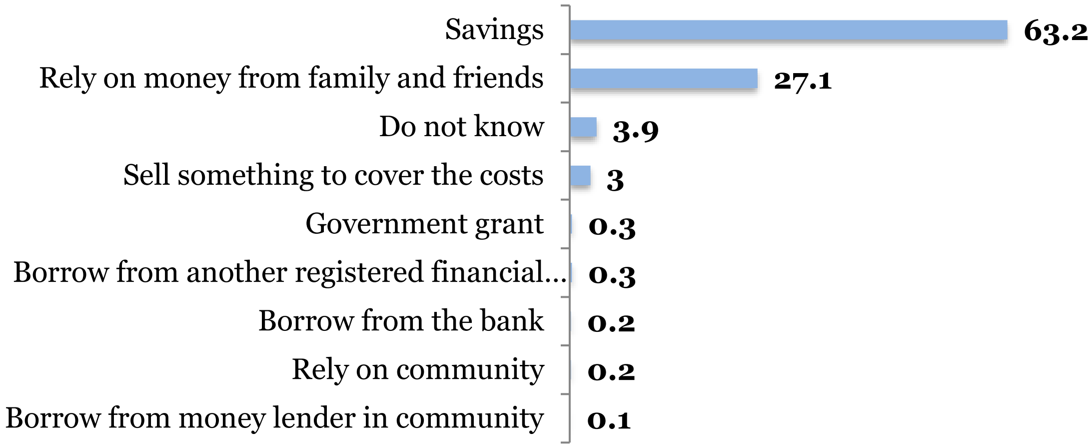


Figure 77 - Mechanisms for old age provision

Other use cases are concerning income shocks related to business or production. Agricultural production in Laos faces multiple risks from pests, diseases, erratic climate and market conditions. Farmers' response to these conditions by diversification and minimising external inputs has been discussed in chapter 5.3 – Use cases and Credit Mechanisms.

Main barriers to the use of insurance products are lack of knowledge and awareness. Most people, asked why they didn't use insurance, responded that they weren't aware or didn't know about it (Figure 78).

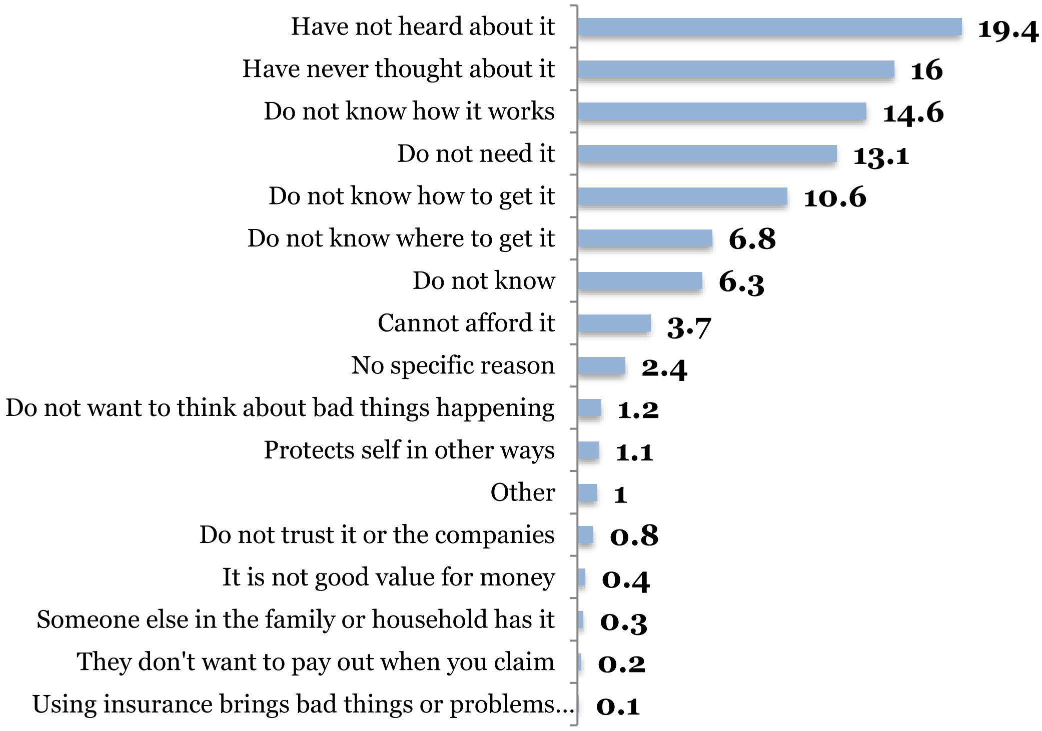


Figure 78 - Barriers for use of insurance

Superstition is a barrier to using insurance. There is a general belief that thoughts about future bad events, including plans to mitigate their effects, actually may attract them to occur. Although this did not come out strongly in FinScope, other discussions suggest that it is an important barrier, amongst some groups, to taking insurance. A GIZ survey on financial literacy in 2015[141] showed ambivalent behaviours: a high short-term preference for the present and immediate future, but some concerns about caring for the distant future and the unexpected. In, the following percentage of respondents agreed with the statements read to them:

short-term preference for the present and immediate future

- I am living a normal life – nothing unexpected will happen – **70%**
- What we do today is more important than what might happen in the future – **84%**

Concerns about caring for the distant future and the unexpected

- I / We keep some money or valuables in order to have a reserve when something unexpected happens – **86%**
- We cannot inflence the future and therefore we should not make any plan – **45%**

Products and Providers

Commercial insurance companies are targeting higher income people and businesses focussing on car insurances (compulsory, complementary, and third party liability), home (fire, water damage, glass breakage, electrical damage, burglary, family liability, liability to neighbours), health (hospitalisation with overnight stay, doctor's visit), travel (medical expenses for disease and accident, accident death, total permanent disability, baggage loss, trip cancellation, flights delays, etc.), and insurance for employers.

Micro insurance products are not generally available, although a number of Microfinance institutions, Savings and Credit Unions and even village funds retain a small part of their profit for social purposes, including compensation for loan default caused by death or other calamities, hereby offering a simple method of a credit life plus insurance. Laos's largest insurance company, AGL, is, in cooperation with the largest microfinance institution, Ekphatthana DTMFI, planning to launch a credit life insurance scheme.

However, the use of formal insurance products barely exceeds compulsory insurance policies, and even these are not enforced. Most insurance policies are for vehicles and other types that are required by law. These requirements are not strictly enforced, and especially in rural areas where traffic police is little active, many vehicles are neither registered nor insured[142].

Health insurance. According to the National Health Insurance Office, 29,8% of the Lao population is covered by health insurance. Poor households are covered by a scheme supported by international donors. Government officials are part of a compulsory health insurance. According to law, also formal employers should register their employees at the governmental Social Security Organisation, but only 36% do actually comply[143].

The social welfare system applies to employed persons only. Health insurance is an integrated part of the governmental social insurance scheme that is regulated by a law of 1999.

Government employees fall under the State Authority for Social Security (SASS). The staff member pays 8% of the salary, and the government tops up with another

8.5%, totalling to 16.5%. The police, and armed forces personnel are covered by a separate system.

The Social Security Organisation (SSO) system covers employees of private-sector and state-owned enterprises with 10 or more employees. Voluntary coverage is available for workers in smaller enterprises and for self-employed persons. Funds are contributed by both the insured person and the employer in the following proportions: (i) Insured person: 4.5% of gross monthly earnings; and (ii) Employer: 5% of monthly payroll with both a minimum and a maximum premium.

The old-age pension benefit is available at age 60 if the insured person has at least 5 years of coverage. Retirement from gainful employment is actually not necessary, and the pensioner is free to earn additional income. Early pension is available at age 55 if the person has at least 5 years of coverage. The pension may be deferred until age 65. The schemes also provides benefits for child birth, invalidity, accident and death.

The systems are administered by the Ministry of Labor and Social Welfare (Table 27). Just recently, in January 2015, all four social security schemes have been transferred into the responsibility of the Social Security Fund Office (SSFO). The SSFO has no separate financial accounting.

Table 27 - Social welfare schemes in Laos *(Source: Ministry of Health - National Health Insurance Office, 2015)*

Name of the scheme	Beneficiaries	Financed by	Number of insured	Premium	Benefits and exclusions
Health Equity Funds (HEF)	Poor households	Government and International Organisations	894,823	around $3 annually per person	Total expenses incl. medical, travel and daily subsistence cost
State Authority for Social Security (SASS)	Government staff (mandatory)	Government and Staff salary	731,584	staff 8.5% and government 8.5% of salary	Covers also spouse and children - 18/23y, loss of income and pension Accidents after working hours and some specific illnesses are not covered
Community-Based Health Insurance (CBHI)	Public (voluntary)	Members	183,253	LAK 5,000 per person and month	Accidents and some specific illnesses are not covered
Social Security Organisation (SSO)	Employees (mandatory, but pres. only 36% of employers comply)	Employers and Employees	163,304	employee max. 4.5% and employer max. 5% of salary	Covers also spouse and children <18y, Accidents after working hours and some specific illnesses are not covered
Private health insurances	Public (voluntary)	Insured (mainly high-income, urban)	47,555	based on requirement of each insurance company	According to specific conditions
			2,020,519	**(29.8% of the population)**	

The majority of the population remains uncovered by social security schemes and relies on own means and support from the extended family. Care for sick and elderly relatives, orphans, disabled or in any other way needy members of the extended family is within the responsibility of the clan.

Funeral funds are existing in some Buddhist communities, covering for the costs of funeral rites of the deceased. It remains unclear although, to which extent these schemes include proactive payment into a common fund, or rather imply collection of money amongst the community upon the case of death of a community member.

Regulatory Issues

Issues on client protection side rather than on provider side. The recently revised Insurance Law from 2011 opens for a wide range of insurance types and several organisational (see chapter 3.2– Regulation of the insurance and Payment Sector).Legislation is little restrictive. As the cost/benefit relation for insurance products and the financial soundness and viability of insurance schemes are difficult to evaluate, there is a high risk for the emergence of pyramid scheme-like insurance providers benefiting from the initial inflow of cash, but collapsing due to mismanagement or miscalculation[144].

Gaps and Opportunities

The present take up of insurance products is mainly driven by compulsory products and – for health insurance – by public health insurance schemes. Although suitable products exist also for low-end customers, voluntary life, health or asset insurance is mainly used by better-off people.

A liberalised insurance sector with increasing competition has developed a range of viable products, although rural areas are hardly penetrated. Until 2007, only one insurance company was operative in Laos. Since then, a number of other companies have entered the market. With their commercial approach they have so far mainly targeted the upper end of the urban market. Their retail network does not extend into rural areas, and there is virtually no promotion. Although there are health, accident and life insurance products that could be relevant also to the lower income segment, very few people actually are aware of them.

Commercial insurance has high growth rates, and will likely continue to play an increasing role. With a growing middle class and an increasingly formalised economy, the market for commercial insurance will continue to grow. As a majority of the population is unaware of insurance products and their benefits, active promotion and information will catalyse the demand.

The product types that are assessed to have the highest relevance for the poor, are also the most difficult to develop in a viable way. According to the risk profile depictured by FinScope (chapter 5.5 – Uses cases and Mechanisms), expenditures caused by health issues and losses of agricultural production caused by pests and weather events are the most common threats to Lao people's livelihood. Health and agricultural insurance have a high level of complexity that make them extremely difficult to implement (see Figure 79) [145].

There are no agricultural insurance products available in Laos, which is not surprising given the fact that there worldwide is no evidence of viable programs.

Considered the relevance of health issues especially for poor people, no satisfactory model for a health insurance is found yet. The two health insurance schemes targeting poor people, the Health Equity Funds (HEF) and the Community-Based Health Insurance (CBHI) do not operate on a sustainable basis and with satisfactory benefits. Benefits are small, and often even not perceived as such by the beneficiaries, partly also due to the very poor services of the public health care system. HEF is depending heavily on Overseas Development Aid funding, and CBHI has not been successful in attracting clients on a voluntary basis. Also health insurance is difficult to offer to poor people on a commercial basis. The most promising models for health insurance are tax-financed systems that are part of a government social security net program. Such a program would require secured priority funding through the government budget.

Given the rather meager prospects to promote formal insurance provision to poor people, the focus should be on alternative mechanisms for risk reduction. In chapter 5.5 – Uses cases and Mechanisms, poor peoples' use of multiple mechanisms for risk reduction are described. Any strengthening of such mechanisms will have a positive effect on poor peoples' risk and disaster resilience. In the scope of this study, we limit ourselves to financial mechanisms though. Especially access to liquid, secure savings and emergency credits has high value for people with small resources – products that the formal sector has difficulties to provide. Especially community-based savings and credit institutions, village funds, are able to provide a basic security net to a market segment that for a considerable period to come cannot be expected to be served otherwise. Thus, once again, the country-wide expansion of the village fund model - once its sustainability can be secured - is assessed to be the single most influential opportunity for better financial inclusion also for risk mitigation.

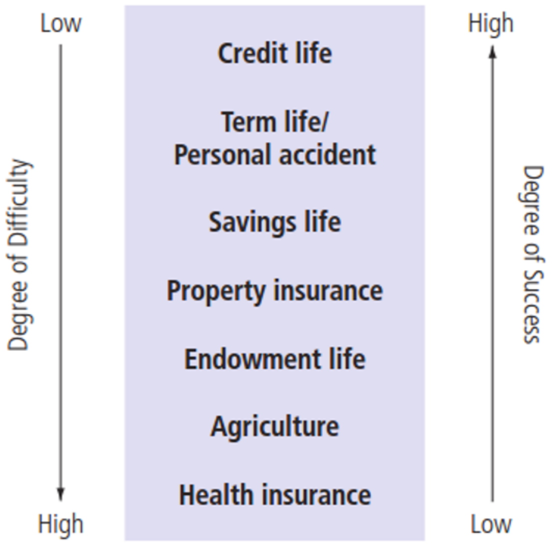


Figure 79 - Difficulty of implementation of micro insurance types *(Source: Helms, 2006)*

6 OPPORTUNITIES FOR AND CHALLENGES TO FINANCIAL INCLUSION

6.1 Cross-cutting Drivers of Financial Inclusion

Economic Environment

The economic environment in Laos provides a strong driving force for increased financial inclusion. Economic growth has been high and robust in recent years and this is likely to continue, yielding higher incomes, which in turn will increase the demand for financial services. The population's confidence that this will continue is high, with 82% of FinScope respondents reporting increasing income over the last year, and 75% expecting that their life will be better in two years[146].

The growth of the financial sector is boosted by other factors that are crucial for economic development. These include the expansion and improvement of the road network, the power grid and the communication network, and the improvement of other public services; these are basic factors for economic development as well as for the development of the financial sector.

Changing patterns of income also increase demand for financial services. As development proceeds, an increasing share of active adults are employed in the formal and informal non-farm sectors. Even within agriculture, there is a transition from subsistence farming to market-based farming. All of this implies great reliance on money and increased demand for financial services.

Migration and urbanisation reinforce the impact of changing employment patterns. More wage employment is usually associated with migration from rural to urban areas, and hence increased urbanisation. The large number of workers earning their wage away from their home and their family fuels the demand for payment services. In many cases, money transfer is the first bank product used by previously unbanked people.

Regional integration is also a driver. Internal (domestic) migration is likely to be supplemented by regional migration, both inward and outward, so that cross-border financial services are increasingly in demand by households. Laos is also centrally situated in South-East Asia, and is a participant in ASEAN regional economic integration initiatives, which include the integration of financial services.

Strong and active state. The Government of the Lao PDR is a strong driver of political and economic development. This has several implications, including that state-owned firms (and banks) are key economic players. Nevertheless there is a strong commitment to private sector development. Also, poverty reduction is a central policy objective. The political system means that when government commits to achieving something, it can meaningfully be achieved.

Financial sector

The financial sector is diversifying. Although it is still bank-dominated, the financial sector is diversifying through new or strengthened non-bank financial institutions, including microfinance organisation, leasing companies, village funds and payments service providers. These new institutions offer a broader range of financial services, and also imply a reduction in the role of government in the financial sector.

Access to financial services is mainly driven by informal and semi-formal providers rather than the formal sector. For many Lao households/adults, especially those who live in rural areas (the majority), their primary point of contact is with informal or semi-formal financial service providers, particularly village funds. Such institutions in many ways provide a better fit with Lao society and the needs of low-income households. However, there are important sustainability issues that have to be addressed.

Competition is helping to increase outreach. The financial sector has been growing rapidly, which is to some extent resulting in increased outreach in terms of both physical networks and products. Many financial institutions are looking for untapped markets and niches in areas that have been underserved, or that have been served by less efficient service providers. Also, government efforts to penetrate unserved areas and population segments have had an impact. Several banks are looking into retail banking and SME banking as their future way to expand, as they perceive the corporate segment as increasingly crowded, and perhaps more risky.

Better products and better access. More competition and improved efficiency in the financial sector has translated into better products and more accessible services. There is fierce competition for domestic savings, especially in LAK, which is focused mainly on product range and innovation. Financial institutions are also looking beyond the core markets of those in formal employment – which is relatively small – to develop products suited to other target markets.

Savings drives uptake. There is a major contrast between the extent of use of savings products and the use of remittances, insurance and credit. Whereas the majority of adults save, only a minority of adults make use of each of the other products. To some extent this reflects an innate conservatism in the population, including an aversion to debt. Savings have multiple functions, including playing an important risk-management role.

High interest rates encourage savings. Interest rates on deposits are generally quite high, which encourages people to save.

In rural areas, subsidised credit schemes and revolving funds have increased access to credit. In rural areas and areas perceived as disadvantaged, the main driver for improved access to financial services have been governmental initiatives and development projects rather than commercial providers. Large amounts of targeted credit have been directed to priority areas via the State-Owned Banks - mainly the Nayoby Bank – through specially created credit schemes and village revolving funds. As a result, rural residents have access to credit almost to the same extent as urban residents.

Increased supply widens the market by stimulating demand. Discussions and interviews also reveal that increased supply by a variety of providers tends to expand the market rather than just creating more competition in existing markets. People use the new products, mostly without abandoning the ones they already use. The growing supply is a major stimulant for a similarly increasing demand. Analysing information from group discussions and comparing villages in similar settings, but with different exposure to financial services[147], it becomes obvious how much demand for financial services is supply-driven. Whenever a new opportunity, a new provider, a new product evolves, people will test them for their relevance and use the service, if they perceive them as beneficial.

Efficiency is increasing with the concept of competition and growing integration into the global context. While the financial sector is growing, its actors are also becoming more efficient. Although the market has been increasing so fast that providers feel competition limiting them only in some segments and areas, competition is nevertheless an ever-present factor. Also the state-owned banks, and especially the country's largest bank, BCEL, have seen professionalisation and improvement of their performance due to decreasing political interference and a development process facilitated by international organisations. The integration of the Lao economy into the regional and global context is conducive also for the financial sector.

Banking Sector

Foreign investment is increasing, and also foreign banking practices are penetrating the sector with mixed effects. Foreign bank branches, subsidiaries, insurance companies and foreign owned leasing companies are quickly increasing their influence, as they typically come to Laos with a business concept that has proved successful under similar conditions, with highly skilled management staff and funding capital to lower costs than capital mobilised domestically. In the bank sector though, foreign influence is - with the notable exception of the ACLEDA Bank and to a lesser extent of BFL - so far limited to corporate and high-end market lending and investment into businesses that are run by companies of the foreign banks' own nationalities. The insurance and the newly emerging formal leasing sector, even though mainly targeting better-off, also have products that reach into the low-end segment.

Microfinance, Village Funds and the informal segment

The microfinance sector has seen large improvements in quality and management capacity. The microfinance sector, including also Savings and Credit Unions and (unregistered) Village Funds, have also experienced institutional progress, mainly driven by donor initiatives in conjunction with improved regulation and supervision.

Village funds have been main drivers for financial inclusion under widely differing conditions, but without proper supervision, the majority of them are unsustainable. The idea of self-managed village funds has been brought to Laos and subsequently improved and extended by development organisations, most often in partnership with a government agency or mass organisation. The flexibility and replicability of the approach has made village funds the single most effective driver for Financial Inclusion in both urban, rural and remote settings. If operated well, village funds can be excellent local financial intermediators. Unfortunately, most of the village funds have been set up assuming the community will run the fund autonomously or under the supervision of the local authorities, which in most cases is not sufficient. An estimated 80-90% of all village funds without regular supervision have run into serious problems, and more or less ceased their operations, with savers losing their funds and a negative impact on the community.

Village funds and microfinance institutions are entry points. However, within the banking sector, only the Nayoby Bank and the Agricultural Promotion Bank have been successful in providing credit to formerly unbanked. For the average first-time user, successful village funds and microfinance institutions are seen as preferred entry points into the financial system, as image disparities and non-compliance with banks' lending conditions prevent many people from using them. Microfinance institutions and village funds introduce the formerly excluded into the concepts of cumulative savings and scheduled credit, both requiring the financial discipline that is necessary to become a successful user of formal financial services, while at the same time providing these services in a more flexible and less intimidating way. Although informal providers, village funds and microfinance institutions are likelier to adapt their services to poor peoples' multiple constraints, there are a few examples of banks that successfully have adopted specialised microfinance methodology[148].

The informal sector fills in where the formal sector cannot provide. A large part of the demand for financial services is of a nature that at this point cannot be readily met by the formal sector. The small amounts that are often involved and the requirement for easy access are reflections of the often insecure and unpredictable financial needs of poor households and small businesses. Uncertainty and a high level of unmitigated risk apply to the living conditions of poor people and their enterprises. But also better-off people and larger enterprises face situations that require quick adaptation and flexibility that are difficult to handle in a formalised way.

Many prefer to use informal services, even though they have access to formal services. For many, the use of informal financial services is the only choice. However, many others, even though they have access to formal services, the use of informal financial services remains a preference, that is more attractive to them, when all aspects and transaction costs are taken into consideration.

A "Missing Middle" in the financial system, and a high level of unintermediated savings. There is a large gap in the financial system between the banks who serve higher income customers and the informal financial service providers who serve lower income customers. Banks hold more savings, by value, than any other type of financial institution, and also have more customers, while the smaller financial service providers such as Village Funds, savings groups and MFIs hold relatively small amounts of savings, by value. In between, savings are largely held in the form of real assets – particularly livestock and valuables such as jewellery and gold - or cash. From a broader, economic development perspective, it is important that savings are available to be applied to the financing of investment – i.e., are available for financial intermediation. This is one of the key roles of the financial system, and of financial institutions, and central challenge of financial sector development is to build these intermediation linkages. The substantial value of savings held in the form of real assets or cash are not available for intermediation and for the financing of investment. While some real assets may play an important economic role – particularly cattle – savings held in the form of jewellery or cash are essentially frozen from an intermediation perspective. Hence a significant portion of household savings are not available for intermediation through the financial system, which may restrict growth in the future as these funds cannot be used to finance investment. A key challenge of financial sector development in Laos is to provide a range of attractive savings options for households – i.e. attractive from a risk, return and liquidity perspective - that are alternatives to real assets, valuables or cash, and gradually attract these non-intermediated savings into the financial system. In the medium to long term, this should help to increase the rate of investment and reduce dependence upon foreign capital inflows to finance investment.

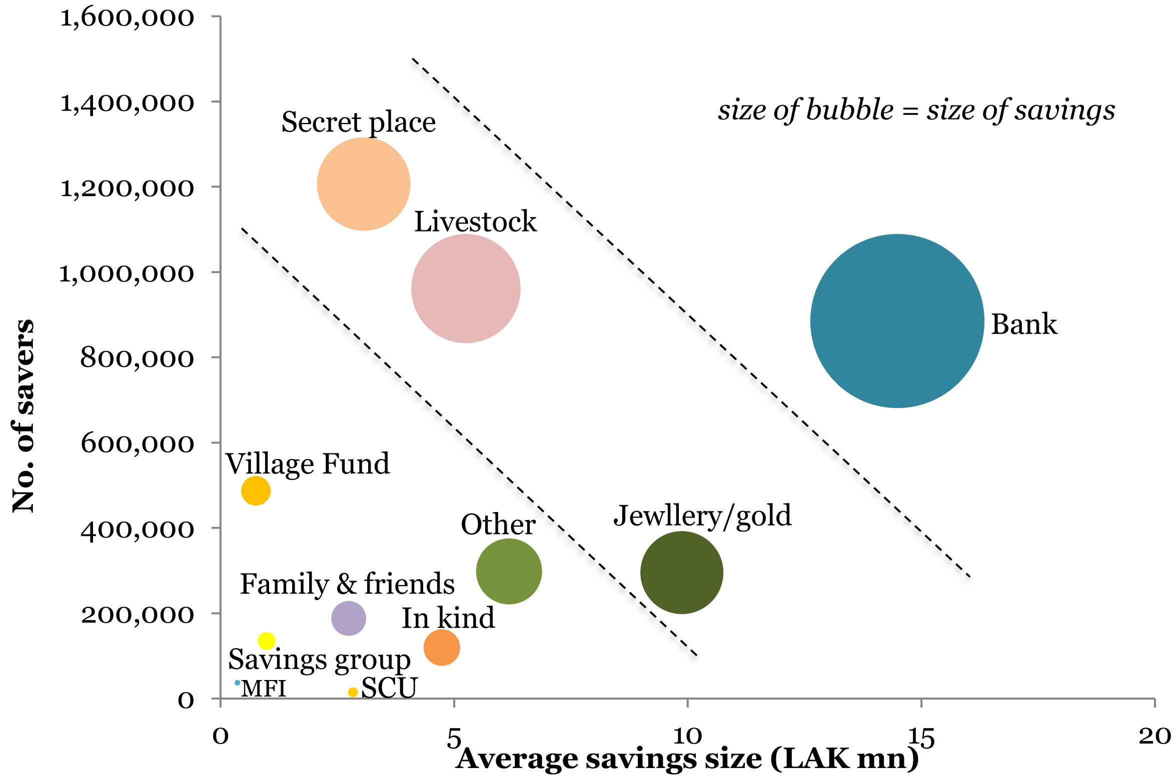


Figure 80 - Savings by type of institution, number of borrowers and amount.

6.2 Key Factors limiting Financial Inclusion

While the drivers for Financial Inclusion mainly relate to the increased demand for financial services, challenges limiting Financial Inclusion are more complex.

Main limitations are only to a lesser extent supply-related access barriers, but rather usage barriers related to demand. The results of the FinScope consumer survey indicate that access to financial services (supply) is not a main limiting factor – according to consumers' own perception, people have access to a range of products and they use it according to their perceived needs. The main factors limiting the use of financial services, and formal financial services in particular, are demand-based usage barriers rather than access barriers of inadequate supply. Taking the whole range of suppliers into regard, people do in general have access to financial services, with informal and semiformal services fitting better into certain needs than formal ones.

Supply-related

Small population, largely rural, sparsely distributed. Laos has a relatively small population compared to other countries in the region, with a low overall population density. The population is largely rural – around 63% - and distributed widely across the country. Much of the terrain is mountainous. Where the provision of financial services is concerned, the small population constrains scope for growth and economies of scale, while dispersed population and difficult terrain adds to distribution costs.

Proximity. In view of the limited physical outreach of branch networks and other financial service providers, and the rural nature of the country, most of the population do not live in close proximity to formal financial service providers. Physical access to these entities is based around visits to markets in district centres. This is convenient for many people, but does not provide for quick access or liquidity. However, almost everybody lives in close proximity to grocery stores, which can potentially offer an outlet for agent-based financial services.

Lack of access to low-cost funds by microfinance institutions and private banks is distorting competition. The different types of financial institutions have different ways to access funds, and some of them are seriously disadvantaged in this regard. Besides having access to government funds, state-owned banks also have a trust advantage in mobilising public savings. Private banks and microfinance institutions do not have this access, and need to pay a premium on top of government banks' savings interest rate to attract clients; since August 2015 this isn't longer possible for banks with the introduction by BoL of a savings interest rate capping regime. Concerning access to foreign capital, microfinance institutions are limited by a 30% ceiling on equity. Commercial banks are not bound by such a ceiling, but so far neither microfinance institutions nor private Lao-owned banks have been able to mobilise foreign funding. The high risk profile of Laos increases the costs of funding[149]. It is also uncertain to which extent Lao financial institutions would satisfy foreign investors' requirements for transparency and performance. At the time of this report, the first two applications for foreign funds by microfinance institutions are under preparation.

Currency mismatch between banks' savings and deposits. Although banks typically pay an interest premium for LAK savings, many Laotians prefer to save in foreign currency - 50% of bank deposits are either in THB or in USD. However, the central bank restricts foreign currency lending by banks to persons and enterprises that have income in the currency of the loan. Although the many customers are interested in lending in foreign currency because of the lower interest rate, with only few persons and exporting enterprises earning their income in foreign currency, banks with a high share of foreign currency savings face a currency mismatch that restricts their ability to lend. It is now possible for some international lenders to hedge the currency risk with the Lao kip but at a considerable premium.

Difficult for financial institutions to recruit qualified staff. It is difficult for financial institutions, particularly Microfinance Institutions and institutions operating in rural areas, to find and retain qualified staff. The general level of education in Laos is very low and only slowly improving. Some larger financial institutions have in-house training facilities and a defined job ladder; the main challenge is the staffing of the medium-level leadership positions.

Microfinance sector is small and faces constraints on growth. In principle the microfinance sector can fill the gap between banks and (unregulated) village funds. However, organisationally and financially sound MFIs find themselves trapped in a legal system of stepwise graduation that does not fit into their linear development – e.g. it is not easy for a successful non-deposit-taking MFI to graduate into a deposit-taking MFI, due in part to capital requirements.

Appropriate balance of MFI regulation difficult to find. While some MFIs are professionally run, others are not, and there are examples of unstable and badly-run MFIs. It is difficult for the regulator to find a balance by applying prudential principles in this business environment, operating with very high risks, without at the same time limiting the scope for experienced, professionally run providers to grow soundly and increase outreach to clients that have difficulties to comply with formal conditions. Regulatory compliance by some FIs is weak.

Substantial upscaling would be needed to increase the significance of microfinance sector, but there are few growth options. If the microfinance sector were intended to increase in significance, to fill in the gap between informal and bank finance, there would be need for massive upscaling. In the short-term, such upscaling would probably be carried out by some of the players that are already operating with a successful business model and relevant products, unless a new, powerful provider steps in with a greenfield approach. Under present conditions, only two or three microfinance institutions have the potential for this, but none of them has been successful in mobilising the required resources under existing conditions. Such upscaling would need a substantial investment in terms of both capital and human resource development.

Poor repayment culture affects credit quality. The traditionally low repayment culture together with lenders' difficulties in enforcing lending contracts is a serious impediment for lenders to expand their lending activities. Lao customs allow considerable flexibility in the interpretation of contracts, and in the majority of financial institutions loan officers have been lenient towards customers not fulfilling their obligations. Most financial institutions in Laos have at some period of their operations incurred serious losses for the provision of delinquent loans. It is obvious that within the last decade the financial sector has undergone a painful learning process on how to prevent and how to deal with non-performing loans. Even though all interviewed institutions reported a trend of presently decreasing NPL rates, and reported NPL are generally low, experts[150] believe that the actual level of repayment problems is substantially beyond those reported.

Low efficiency due to low-performance culture. In most financial institutions, operations are slow and staff are working inefficiently due to excessively bureaucratic processes, centralised decision-taking and a working culture that takes little regard to actual performance.

Despite a positive developments, there is still plenty of room for improvement of products and lending methodology. Even though the bank sector is undergoing fast and positive development, its product range is still limited and has little relevance to the low-end segment. Most financial institutions' rigid loan application procedures - in banks often also including bribes or good connections to promote the progress of one's application - and demands for collateral are preventing many resource-poor clients from applying for loans. Lenders, also including Microfinance Institutions and informal lenders, have been very focused on titled land and other fixed assets as security for loans. Accepting payrolls of formally, mainly government-employed persons as collateral is a relatively recent innovation that has brought one particular MFI[151] much success. Moveable assets are rarely accepted as collateral[152].

Group lending/social collateral not widely used. In general, group lending and the use of collective guarantees is not successful in Laos, because the concept is rarely understood literally as such by the clients - the term 'guarantor' is mostly understood as simple 'witness' without financial responsibility in the case of other group members' default. A few institutions, however, such as the Xainiyom MFI and some successful village funds, have been successful in mobilising social collateral.

Little inclination to develop better products. It remains a problem to make the typical features of poor people's demand for financial services - small amounts, irregular income, and low value assets - fit into the requirements of formal finance. Banks and non-bank financial institutions using conventional bank methodology have had little success in penetrating the lower-income segment. Microfinance methodology has been adopted only by a few institutions, and there appears to be little innovative energy within the sector, with little effort made by financial institutions to develop products that e.g. are cash-flow based, use alternative collateral or high-frequency collection of savings or loan instalments.

Subsidised credit increases access but not sustainability. The provision of subsidised credit, particularly to farming households through Nayoby Bank has the short-term impact of increasing access to finance by making credit to households that would otherwise find it difficult to access credit. This credit is subsidised through low interest rates, and little attention being paid to repayments. However, this may not contribute much to financial inclusion in the longer-term. Subsidised credit is expensive, and may not be sustainable. It discourages financial institutions from attempting to penetrate this segment of the market – all the more in the Government priority districts where subsidized credit provision is concentrated -, and encourages a lack of credit repayment discipline amongst borrowers.

Still a gap in the market for SMME credit. With consumer credit increasingly available, and subsidised (policy) credit available to many farming households, the lack of provision of SMME credit is a notable gap in the market.

Demand-related

High interest rates are an impediment to credit for some long-term investments. Although the high level of interest rates has been listed as a positive factor for financial inclusion in Laos, through its impact on savings, it is also a constraint to credit provision. It is a major reason why large, long-term investments, which may not be highly profitable - as is typical for the agricultural and manufacturing sectors - have difficulties in obtaining commercial funding. The same applies to household borrowing for mortgage finance. It is less of a barrier to short-term consumer credit and to commercial credit for trading activities.

Demand for financial services is low in remote rural areas. It has been mentioned earlier that the main factors limiting people's use of financial services are on the demand side. Especially in rural areas, the demand for financial services is still low. Many people either feel that there is no need for them to use financial services, or they feel unqualified to do so. There is also awareness of the risks of indebtedness, especially among the rural population. The less a society is monetised, the less relevant is the concept of financial services. Although there is no place in Laos where money is not used as medium of exchange and store of value, remote rural areas still widely rely on self-subsistence, with sale of surplus production or gathered non-timber forestry products. When villagers get the opportunity to deposit their money and take credits e.g. in a community-based, easily accessible village fund, they only use it to a small extent, and mainly for emergency situations and for bridging liquidity gaps[153].

Emerging demand is mainly informal. When villages gradually become integrated into the market economy, and a greater share of their produce is sold, financial services become more relevant. However, even with a considerable cash flow, many will be reluctant to use the formal sector because of inconvenience, lack of knowledge about financial products and a general timidity towards formal institutions. In these settings, both rural and urban, locally managed village funds have the potential to introduce people into the financial sector.

Mental barriers towards banks. Concerning the use of bank services, particularly bank credit, consumers' perception that 'bank services are not for their kind of people' is very strong. Even they might be eligible for bank lending, and aware of the lower interest rates compared to microfinance and informal lending, there is a strong mental barrier to even trying to apply for a loan. Banks are perceived as providers to the wealthy, and poor people feel ashamed about bringing their small issues to the bank. State-owned banks and private banks, except ACLEDA Bank, have in recent years heavily invested in large and shiny office buildings on top of imposing staircases. These and the highly formal settings with counters and uniformed officers inside have increased the distance between banks and 'the people'.

Difficulty in identifying creditworthy lending projects. Although there some financial institutions may be constrained in terms of availability of funds, the banking system as a whole is not sure of liquidity and loanable funds; at present it is not seen a major limiting factor for the present pace of expansion of financial institutions. Instead, financial institutions consider that the binding constraint to credit is identifying loan applications fitting the institution's lending policy. This is particularly a problem for SMME credit.

Financial skills do not meet requirements. Because of the rapid development of the Lao economy alongside an underdeveloped education system, there is a large gap between the requirements and availability of skills for a modern economy. The transition from a subsistence economy to an emerging development economy requires a different set of skills, ranging from basic numeracy to understanding of the concepts of investment and financial discipline.

Financial Inclusion is also restrained by consumers' lack of awareness and experience: even though relevant financial products are available, it will take time for consumers to appreciate them. As with other innovations, the adoption of financial products in traditional communities follows a certain sequence with an initial pioneering group, the majority following the initial success, and the poor lagging behind. This picture, however, is blurred in the case of financial services, because poor and well-off have clearly distinct financial service needs.

Cautious attitude towards credit. Many Lao households are very cautious about using credit. This is partly because credit products are not well understood, combined with a fear of indebtedness. Furthermore, for those who have borrowed, the beneficial impact is unclear. In FinScope, only slightly more respondents agreed than disagreed with the statement that ‘My life has improved after borrowing money’, casting doubt on credit takers’ ability to manage credit funds to their own benefit.

6.3 Outlook: Trends and Opportunities

Overall trends

The economic climate is likely to continue to be favourable. It is expected that stable and strong economic growth will continue to be an important driver of financial sector development. Economic growth is predicted to remain reasonably high, although there are risks from slowing regional and international economic growth.

Credit is likely to play a larger role. FinScope identified savings and transactions as the main current drivers of financial inclusion. However, the present trend of credit expansion indicates that credit is likely to play an increasing role in poor people's financial behaviour, especially if the government continues to encourage people to take credit as 'way out of poverty', and actively promotes lending by state-owned banks in particular.

Furthermore if general economic development continues to broaden opportunities for profitable, income-generating activities, this will create additional demand for credit.

But credit expansion comes with a risk. In urban areas in particular, consumption-based indebtedness is on the rise. If indebtedness grows faster than debt-service capacity, there will be an increasing in overindebted households, resulting in financial stress that will ultimately impact on the financial system's performance and stability.

Excessive credit growth and over-indebtedness could cause poverty to rise rather than fall.

Interest rates should decrease. Increasing competition in the banking and non-bank financial sectors, along with improved risk management on the provider as well as on the client side, and increased efficiency within the financial sector, should lead to lower interest rate spreads and lower lending rates in the medium term.

Increasing cooperation and integration will be beneficial for the consumer. The Lao financial sector has been affected by a lack of internal and regional integration. Recent years have seen improved facilitation of FDI and international remittances via the SWIFT network, and there is likely to be further regional integration under ASEAN initiatives. An interbank payment platform in LAK is now up and running, while interbank payments in foreign currencies still need to be cleared via the central bank. Since 2015, Bconnex, an ATM alliance between 9 banks, makes it possible for these banks' clients to use each others' ATM network. This trend of integration and cooperation is likely to continue. The resulting cost savings will benefit clients and encourage the use of formal payment services.

Technological developments will create new opportunities. Laos has been behind the curve in the utilisation of opportunities created by technological change in the financial sector. This is likely to change as catch-up takes place, driven by a mixture of firm-led innovation, spillover from neighbouring countries and broader international developments, and consumer demand.

Future provision of financial services to the poor

Banks will grow 'downwards' towards low-income and rural segments. Banks are the most important provider of financial products in Laos, even though they do not provide products that are relevant to poor people or have delivery channels that can reach remote areas. However, it is expected that the gap between the use of banks by low-income households and the banks' supply of financial products will diminish over time. With increasing market integration and economic activity, the demand for banking services will grow. Facing increased competition in the high-end market, some banks will extend their operations downmarket; with improved infrastructure and growing demand it will become profitable for them to extend their network of service points and products into new areas.

Banks can be particularly powerful in improving Financial Inclusion, if they choose to do so. Few banks have the mindset and expertise to apply microfinance methodology, which is clearly distinct from the kind of business they have been concentrating on. However, if banks do commit to providing services downmarket, they can be particularly powerful to deliver and achieve scale, because they have the resources and capacity to absorb set-backs.

The potential of new technology. Evolving delivery channels are likely to be supportive in the development of banks' (and other financial institutions') ability to reach poor customers. Alternative channels like mobile banking teams or digital finance using mobile phone technology or smartcards can have a huge impact on the cost of delivering financial products, and hence their pricing and potential uptake. The fast growing network of ATMs in Laos is actively used by recipients of salary payments, public benefits and remittances, and this is likely to be extended once mobile money services are available throughout the country. While banks are likely to be important users of digital financial services, the impact will extend far beyond banks, and other financial institutions will also provide financial services to un-served or under-served households.

Increasing demand for formal finance. As poverty is reduced and household income rises, the demand for formal finance will increase. There will be more demand more credit for commercial purposes, as well as more savings deposits. The increasing share of consumers with income from salaries will add to the use of formal payment, savings and consumption finance.

Nevertheless an important role will remain for non-bank financial institutions. Despite a growing role for the banks, some of the emerging demand will remain unbankable. The image mismatch that prevents many people from using banking services will take many years to break down. Until then, this market segment will mainly be served by institutions that are using methods that are adapted to the low-end segment. A variety of in-, semi- and formal providers of microfinance is needed to absorb poor peoples' demand.

Formal NBFIs such as leasing companies and microfinance institutions can play a more significant role in financial inclusion. With their present pace of growth, leasing companies can be expected to cover a considerable part of the demand for consumption finance. A few established microfinance institutions have developed business models and organisational stability that would be replicable for large scale expansion. However, the present framework is inhibiting the growth potential of these institutions vis-à-vis its competitors. Microfinance institutions are squeezed in between banks and village funds, with increasing competition pressure from both sides. They will continue to fill specific local niches without playing a major role, unless large-scale upscaling of qualified microfinance institutions with external support becomes possible.

Village funds are at a crossroads, and can play an increasingly important role or continue to experience problems. The future role of village funds will depend largely on whether the model that has succeeded in some places can be extended on a nation-wide basis, and maintained. Village funds have considerable potential to provide basic financial services to low-income households. They can easily be upscaled and adapted to the local context. Low fixed costs and running costs make it particularly cost-efficient. If run well, village fund services give people that are inexperienced in the functioning of a monetary, diversified economy a unique learning opportunity for decentralised administration and local governance, as well as for the formalisation of transactions and the financial discipline coming with the use of financial products. Unless they have been mismanaged, village funds are often the first choice for low-income consumers. It is for these reasons that the Lao government has decided to equip every village in Laos with a village fund.

However, the advantages of the model come with high risks. Village funds' low costs are partially linked to their use of members of the community for management; they have detailed knowledge of the community (an advantage), but mostly have low formal education. In addition they are mostly unsupervised and do not comply with prudential principles for managing financial institutions.

Unless the government can create a common vision on the role and operations of village funds, and launch a nation-wide program to ensure regular supervision and high-quality support, a patchwork of 'good' and 'failed' village funds will result, which will, respectively, promote or damage financial inclusion. Corrupted village funds lead to the loss of financial and social capital, an outcome that can and should be avoided.

Village funds need regular, high-quality supervision. Several projects have dedicated themselves to making the village fund model sustainable. With its promotion of self-owned Network Support Organisations, GIZ has proved that it is possible to run savings-based village banks with a respectable and sustainable performance. Plans are being developed to make this approach a national reference model, including the establishment of a national apex body.

Informal practices will continue to fill the gaps. Informal practices including borrowing from relatives, peers and moneylenders, trader credit, unlicensed services as well as unregistered (illegal) operations of licensed providers will continue to fill the gaps that formal and semi-formal providers cannot service.

7 IDENTIFYING FINANCIAL INCLUSION PRIORITIES AND RECOMMENDATIONS

7.1 Identifying Priorities

This Diagnostic Report identifies a number of gaps and opportunities to extend financial inclusion in each of the four product markets.

As a basis for drawing up the financial inclusion roadmap, this section concludes on the key financial inclusion priorities and provides strategic recommendations for unlocking each priority.

Priorities should support the welfare policy objective. Financial inclusion can improve welfare by reducing transaction costs, improving households' opportunities to access goods and services, offering tools to mitigate risks, increasing accumulation of capital and allocating such capital to productive opportunities. Financial inclusion interventions should be prioritised according to those opportunities that best meet the welfare objectives.

Products		Dependents	Informally employed	Low income farmers	High income farmers	Low income formal empl.	High income formal empl.	Low inc. non-farm self empl.	High inc. non-farm self empl.	Est. potential clients ('000)
% of adults		7.2%	12.2%	24.8%	23.4%	8.3%	7.6%	9.0%	7.6%	
average income		1.05	2.01	0.33	2.62	1.10	3.26	0.76	6.77	
Credit	Personal loans	5%	15%	15%	10%	5%	10%	15%	15%	507
	Asset	5%	0%	5%	0%	0%	0%	5%	5%	104
	Housing	0%	0%	5%	0%	5%	5%	5%	0%	106
	Productive credit	5%	15%	10%	20%	5%	5%	15%	15%	538
Savings	Retirement	5%	15%	10%	15%	15%	30%	15%	20%	620
	Accessible/liquid savings	40%	50%	55%	55%	50%	45%	45%	45%	2,152
	Healthcare	60%	70%	75%	85%	70%	70%	65%	75%	3,152
	Education	10%	20%	25%	50%	35%	40%	30%	30%	1,361
	Capital accn	5%	20%	25%	35%	20%	35%	15%	40%	1,102
Payments	Payments	40%	50%	20%	40%	60%	60%	60%	75%	1,869
	Remittances	60%	25%	25%	40%	45%	40%	35%	40%	1,528
Insurance	Asset	5%	10%	5%	15%	20%	30%	20%	35%	626
	Health	20%	25%	15%	20%	15%	20%	30%	25%	862
	Crop	0%	0%	5%	10%	0%	0%	0%	0%	153
	Credit	5%	10%	5%	10%	5%	10%	5%	10%	321
Financial literacy	Debt management	55%	70%	50%	50%	60%	60%	45%	55%	2,315
	General	45%	50%	70%	60%	35%	30%	45%	25%	2,210
	Risk management	35%	30%	40%	35%	35%	25%	10%	20%	1,343
Consumer protection	Credit information	5%	10%	5%	10%	5%	10%	5%	10%	321
	Market conduct	35%	30%	30%	60%	70%	80%	50%	85%	2,149

% of adults

Highest Need → Lowest Need

Impact:

High **Medium** **Low**

Figure 81 - Priorities matrix

Note: percentages relate to proportion of target group that can be potentially impacted through the development of appropriate products

Priorities identified based on needs and potential reach. The key financial inclusion priorities are identified in Figure 81. It shows the potential for deeper reach of different financial services in each of the various target market segments (grey shading, with darkest shading indicating largest potential), as well as the number of people and average income of each segment. To the right it indicates the estimated potential clients that could be impacted for each financial service type and the welfare impact that could be had from that service based on the various impact transmission channels. On this basis, the likely impact is ranked as high (green shading), medium-level (yellow) or low (red). The derivation of the priorities matrix is explained in the Appendix A.

Main priorities are related to specific needs as well as products with wider benefits, along with cross-cutting issues. The most significant impact for financial inclusion is possible where the focus is placed on enabling formal domestic remittances, low cost savings and healthcare-related risk-management products. Beyond this there are needs that have benefits beyond financial inclusion. For instance, the major credit need is for sustainable agricultural and MSME credit, which is much more than an access to finance issue and will have wider benefits, in terms of job creation and diversification of economic activity, if sustainably delivered. There is also a major need for improved consumer protection and enhanced financial literacy across the population.

7.2 Seven Key Priorities

Based on the needs of the various target markets, as well as the nature and challenges to provision evidenced through the analysis, we identify the following seven priority strategies to capitalise on these opportunities, which are likely to have the most far-reaching impact on financial inclusion, given the nature of the target markets:

- Improving the payments eco-system through mobile money, digital financial services, and improved payments infrastructure
- Extending the outreach of banks and other financial service providers, through an enhanced range of products and extended physical networks
- Strengthening village funds to ensure sustainability
- Improving the availability and sustainability of credit provision
- Developing accessible risk mitigation products
- Promoting linkages between financial institutions and sectors.
- Consumer empowerment and protection

These are not the only opportunities for enhanced financial inclusion. However, these seven strategies are likely to have the most far-reaching impact on financial inclusion, given the nature of the target markets. Below we unpack each of these strategies in more detail, considering the nature of the opportunity, the main challenges to be overcome and potential actions to realise the opportunity.

1. **Improving the payments eco-system through mobile money, digital financial services, and improved payments infrastructure**

The payment system in Laos is relatively undeveloped, and there are many opportunities for further development. There are two main objectives of action in this area. The first is to use the payment ecosystem to extend financial services to lower income households, especially those that are currently less well served. The second is to upgrade the core infrastructure of the payments system to ensure that banks and other financial institutions have access to reliable, low cost payments services

Benefits. Mobile money (MM) and potentially other digital financial services (DFS) have the potential to fill some of the gaps in the financial sector and make available a broader range of financial products and services to those who have limited choices at present, whether because of proximity barriers, "doorstep" barriers (lack of perceived relevance and suitability of some formal financial services to lower income groups), or cost barriers. Mobile money can directly offer a range of payments, remittance and savings services to customers, and can also act as a distribution mechanism for products offered by other service providers (such as micro-credit and micro-insurance). Mobile money potentially offers low transaction and usage costs, as well as convenience through a widely distributed agent based distribution network.

More efficient/lower cost remittances will have particular benefits for dependents, whose income is mainly derived from payments received from others. The dependents group has relatively low income, and reducing the costs of sending/receiving remittances could help to increase their disposable income. As cash-based payments are gradually replaced by digital payments, information flows are generated. These can help to unlock access to credit, by providing information on individuals' financial capacity. They will also help to improve the ability to levy taxes on businesses.

More generally, improved payments infrastructure will help to reduce the costs of payments, improve efficiency, reduce risks and reduce reliance on cash. Easier access and ability to make payments and transfers across sub-sectors (e.g. between bank and mobile money products).

Challenges. Mobile money is at a very early stage in Laos, with one bank offering a mobile-based money transfer service, and one MNO about to embark on pilot schemes. Hence the model is as yet untested in Laos, and it is not known how quickly there will be customer take-up, especially amongst the relatively unsophisticated rural population. The extent and effective operation of agency networks will be key, and the initial pilot models, product design and pricing may need some refinement to ensure that they work.

Substantial investment is required in order to develop core payments infrastructure. Payments system development is complex and technically demanding, requiring high-level skills, expertise and technical support. Furthermore a solid legal framework needed. The payments system involves a range of entities, including banks, other financial institutions, the Post Office, MNOs, and technology service providers, and channels are needed for effective communication on payments system development issues.

Action items. MAFIPP is already providing extensive support to aspiring DFS providers as well as to the BoL, and this support should continue. Important action items for MAFIPP's DFS project, banks, MNOs and the BoL include the following:

Mobile money

- Introduce mobile money systems; get pilots up and running;
- Refine business models on the basis of pilot experience, and move from pilot

to full nationwide roll-out as quickly as possible;
- Ensure that agent networks function effectively, providing adequate liquidity for cash-out demands, and that mobile money agents have convenient facilities for rebalancing cash and e-value;
- Ensure that agent networks penetrate areas beyond the current reach of banks;
- Encourage other banks and MNOs to consider MM products;
- Introduce cross-border mobile money (especially Thailand-Laos);
- Introduce products linking mobile money to bank accounts.

Payments infrastructure

- Ensure that high-level settlement infrastructure (RTGS) is effective and functional, and require banks to participate;
- Establish clearing mechanism for interbank payments instruments (cheques, EFTs) with appropriate data communications channels;
- Consider national switch linking banks, retail point-of-sale (POS) terminals, mobile companies etc., enabling payments functionality across channels (e.g. bank/mobile);
- Participate in regional (ASEAN) cross-border payments and settlement system.

Regulatory

- Finalise draft MM regulations to provide more certainty in the regulatory environment for MM service providers;
- Finalise a comprehensive legal, regulatory and reporting framework for payments, encompassing both core, high-value clearing and settlement systems, as well as retail payments service providers.

Developmental

- Facilitate cross-border mobile money;
- Consider the case for offering grants/subsidies to agents in more remote areas in the early stages of mobile money development;
- Establish payments service providers association for discussion of issues of concern to the industry;
- Promote inter-operability between different mobile money platforms and between non-bank mobile money providers and banks.

2. Extending the outreach of banks and other financial service providers (physical outreach and product design)

The objective of this priority is to encourage banks and other financial service providers to extend both their physical outreach and improve product design in order to make them more accessible to low-income households.

Benefits. Moving banks beyond their current focus on urban areas and serving higher income / formally employed consumers can extend access to banking to under-served customers, providing them with a wider range of financial service choices and alternatives to informal/semi-formal providers. Similarly, other financial service providers, particularly MFIs and leasing companies, can help to increase customer access through extended branch and agency networks.

Challenges. Rapid economic growth and urbanisation has enabled banks to grow profitably. With some exceptions, there have been few attempts by banks to develop more extensive distribution networks, and product design has not been particularly innovative, particularly for consumers with low and/or irregular incomes. The business case for such outreach may be weak, given the high costs of penetrating rural areas through branch-based networks, and the limited economic capacity of rural households. There are also some regulatory barriers to branch network expansion. However, competition – particularly amongst private banks – should provide an incentive for innovation in mobilising deposits and sustaining/increasing market share, and technology should support low-cost expansion of outreach, for instance through agent / branchless banking. MFIs and leasing companies are also subject to regulatory restrictions on the opening of new branches, which inhibits the growth of branch networks.

Action items.

Products

- More innovation in product design, moving beyond traditional products, to those more suitable for low-income households

Regulatory

- Remove regulatory barriers to the establishment of new branches by banks, MFIs and leasing companies, such as additional capital requirements.

Physical outreach

- Banks need to be more innovative in extending distribution networks through branches and non-branch channels;
- Investigate the potential for branchless banking using independent (third party) agents, such as retail stores, who would provide banking services on behalf of banks;
- Consider strategic alliances between banks and MFIs.

3. Strengthening village funds to ensure sustainability and extended relevance to rural populations

Benefits. Villages Funds (VFs) are probably the main set of financial institutions that are of relevance to poor households, and provide many such households with access to semi-formal savings and credit products. In many respects they have a good cultural and social fit. VFs are low-cost to operate and can offer depositor-members good returns. Improving the functioning of VFs by addressing sustainability issues through a more formalised regulatory and supervisory environment, along with appropriate support services, could improve the level of trust and confidence in VFs, enabling them to play a more effective role in providing financial services to poor households, and support the building of linkages between VFs and other financial institutions (banks and MFIs).

Challenges. While there are a minority of successful, expanding and sustainable VFs, the majority are thought to be unsustainable under current arrangements. Responsibility for supervision is unclear, and most of them are effectively unsupervised. There are risks facing VFs of all sizes, and savings deposits are at risk. VFs are important politically, but do not have a champion that is willing to drive the sector as a whole towards sustainability. The GIZ-AFP VF project has shown that VFs can be successful and sustainable, with appropriate support and supervision through regional apex organisations, but this only covers a minority (approx. 10%) of VFs.

VFs are important politically, and there are many different institutions and groups that have an interest in their success. However, there is no dominant institution or champion that is willing to drive the sector as a whole towards sustainability. It will therefore be necessary to mobilise broad-based political support for the objective of stabilising the VF sector and undertaking reforms, committing resources to ensure sustainability and fulfilment of potential.

Action items. Strengthening VFs as a whole to move the sector towards sustainability will not be an easy task, and requires the co-ordinated actions of a wide range of stakeholders. The following actions items are required to achieve this:

Regulatory

- BoL should take on regulatory and supervisory responsibility for the VF sector (although it should not take on direct responsibility for supervising all VFs);
- BoL should establish a set of regulations, covering operating procedures, accounting and reporting requirements, cash management, risk management, provisioning etc., applicable to all VFs, perhaps graduated and related to size;
- BoL to take direct responsibility for supervising the larger VFs (with a balance sheet size above an agreed level);
- Delegate supervisory responsibility for smaller VFs (the majority) to regional support organisations;
- Develop regulations for VF support organisations and supervise them.

Developmental

- Mobilise broad-based political support for the objective of stabilising the VF sector and undertaking reforms, committing resources to ensure sustainability and fulfilment of potential;
- Utilise experience of GIZ-AFP project to roll out effective support and supervision mechanisms for VFs nationwide;
- Promote establishment of regional VF support organisations; or conversion of existing entities to more effective and properly structured support organisations;
- Establish third tier VF organisation for training, auditing;
- Consider Nayoby Bank as provider of wholesale credit to successful VFs.

4. Improving the availability and sustainability of credit provision

Benefits. Credit is the least-used of the four financial product categories, and if properly provided and understood by borrowers can play an important role in boosting economic activity by supporting investment by farmers and MSMEs. It can also assist households in financing the acquisition of large assets (e.g. housing) that would otherwise have to be paid for out of income, in coping with fluctuations in income and in dealing with emergencies. Extending the range of types of credit available will help to make the provision of credit more effective. A large proportion of the credit that is available is provided as subsidised policy lending by government banks. This is expensive, and reforming the provision of subsidised credit can make it more effective and less costly.

Challenges. The credit market is distorted by regulatory restrictions (e.g. interest rate caps), and the provision of subsidised credit by government. Hence it is difficult for an effective credit market to develop. There is evidence of over-indebtedness amongst some groups of borrowers. Furthermore, many borrowers do not understand credit well, which can lead to the provision of credit on non-transparent and inappropriate terms and conditions. The range of available credit products is narrow, and there is a high reliance on collateralised credit. The primary objective of this priority is to increase access to credit for investment in productive activities, household assets and education; risk management; and consumption smoothing. Credit for investment is focused on MSMEs as there is currently no bottleneck in agricultural finance given the level of credit already available.

Financial institutions

- Pay more attention to ability of borrowers to service debt on the basis of cash flow;
- Develop new credit products especially those not dependent upon collateralised lending;
- Develop insurance products to support credit (e.g. credit life, whereby debt dies with the borrower);
- Develop MSME credit through lines of wholesale credit, guarantee funds;
- Develop refinancing linkages between financial institutions (e.g. banks to non-deposit taking MFIs).

Subsidised credit

- Review the provision of subsidised credit by government with a view to reform that will help to reduce fiscal costs and improve credit discipline and impact effectiveness;
- Seek to learn from relevant international best practice.

Regulatory

- Review the impact of caps on interest rates on lending by financial institutions;
- Require banks and other lenders to consider the ability of borrowers to service debt on the basis of income rather than simply considering collateral;
- Introduce rules on product information disclosure (e.g. APRs on credit and savings) and restrict credit institutions from using flat rate credit;
- Improve the effectiveness of credit information collection and sharing, by extending compulsory participation in and sharing of information with the credit information registry and requiring lenders to ascertain the credit record of borrowers before making new loans.

5. Developing accessible risk mitigation products

Insurance take up is limited in Laos, especially in segments other than the formally employed. However, some other financial products are used for risk management purposes, especially savings and credit.

It is proposed to increase access to well-designed, cost-effective risk management products.

Benefits. Enabling people to use an appropriate range of financial products – savings, credit and insurance - to better guard against risk and mitigate the impact of risk events.

Challenges. Limited understanding of risks and risk management, especially insurance. Limited availability of products and distribution channels.

Health-related risks and expenses are main concern for households.

Actions.

Regulatory

- Develop regulatory framework for micro insurance.

Financial Institutions

- Development of micro-insurance products (better suited to people with low/irregular incomes);
- Development of broader range of insurance products (e.g. credit life);
- Ensure availability of products for health-related risks;
- Development of new distribution mechanisms.

Financial Literacy

- Financial literacy for understanding of insurance and risk management.

6. Promoting linkages between financial institutions and sectors.

Benefits. Financial sub-sectors are segmented and have limited linkages, and serve different parts of the population. Building linkages would help institutions to grow, build capabilities, extend outreach, and would also enable customers to get access a wider range of products and services. Microfinance institutions (MFIs) have grown rapidly in recent years. Although the sector still remains small, they provide an alternative source of credit and savings, and in some cases operate down-market. If the sector can grow, it can potentially play a role in the financial sector by filling part of the gap in the "missing middle" between banks and SCUs/VFs.

Challenges. The currently envisaged graduation path between different types of financial institutions is not functioning well and is not realistic, as there are barriers to growth and transition from one type of financial institution to another. The regulatory framework is not conducive. The MFI sector is relatively new and small, and lacks the large MFIs found in some other countries lacks. While MFIs can play a role in filling the gap between banks and VFs, at present they are squeezed between them. Growth is constrained by regulatory restrictions, a lack of access to capital, and uneven regulatory requirements across financial institutions.

Actions.

Developmental

- Build linkages between types of institutions, e.g. between banks and MFIs, and between banks (especially NBB) and village funds. These linkages could be of different kinds, including refinancing (provision of wholesale funds by banks to other financial service providers) and even client referrals;
- Seek large investors (especially foreign) to invest in the MFI sector;
- Encourage non-deposit-taking MFIs to grow and graduate into deposit-taking MFIs.

Regulatory

- Remove regulatory restrictions on expansion of distribution networks, e.g. the capital requirement for new MFI branches;
- Remove regulatory restrictions on MFIs on raising capital from foreign sources;
- Equalise the regulatory requirements, e.g. regarding classification and provisioning for bad debts, and liquidity and capital adequacy requirements, across banks and MFIs;

7. Consumer empowerment

Benefits: It is critical to empower consumers through education and protection so that they fully benefit from finance. The result should be better understanding and improved ability of consumers to choose and use appropriate products; protection of consumers; and reducing the dangers of over-indebtedness.

Challenges. There is a lack of understanding of financial concepts, products, and a low level of numeracy. Building understanding of financial issues is a long-term process. A broad range of interventions is needed, involving stakeholders beyond the financial sector.

Channels for consumer redress are ineffective, as are restraints on market conduct / abuse. Access to information regarding financial institutions is limited, thereby undermining the ability of consumers to take well-informed decisions. There is also a need for a more consistent and transparent regulatory environment.

Financial literacy

- Encourage financial institutions to develop financial literacy amongst their customers;
- Aim to integrate learning on financial literacy into the education system;
- Develop financial capacity of SMMEs.

Consumer Protection

- Require dormant bank account balances to be transferred to the BoL;
- Establish compulsory procedures in financial institutions for dealing with customer complaints;
- Introduce rules on product information disclosure (e.g. APRs on credit and savings) and restrict credit institutions from using flat rate credit;
- Extend depositor protection (deposit insurance) beyond banks to MFIs.

Regulatory

- Ensure that all financial institutions report publicly, consistently and in a timely manner that meets current legal requirements, and that all relevant financial sector statistics are regularly published;
- Ensuring that all existing laws, regulations guidelines and directives relating to the financial sector are publicly and readily available;
- Ensure that AML/CFT regulation is more effectively implemented;
- Introduce tiered KYC regulations;
- Faster finalisation of draft laws and regulations;
- Ensure that there is consistency in regulatory requirements across different but similar types of institutions, and consistency in interpretation of laws and regulations.

7.3 Policy and Regulatory Imperatives

MAP provides the opportunity for a re-orientation and re-invigoration of the policy and regulatory framework to give a stronger emphasis to the needs and dynamics of financial inclusion. Key elements of this will include policy strengthening, with a firm commitment to financial inclusion, backed by resources where necessary, a recognition that the market alone will not be sufficient to bring financial inclusion to un-served and under-served, and that additional interventions will be necessary. There is also a need for regulatory modernisation, with a recognition that banks will not necessarily be the main type of financial institution relevant to extending financial inclusion, and that it will be important to include achieving sustainability for village funds as a key tool. This will require both an improved, more effective regulatory framework for village funds and support for both institutional and regulatory capacity building.

8 GOING FORWARD

Laos is fairly well served, financially, compared to some peer countries. However, the analysis shows that there is still significant opportunity for improved access to support welfare and growth policy objectives. In particular, financial inclusion is narrow, and does not extend far beyond the use of savings products.

In this report MAP has identified seven priority areas that will provide the largest marginal gain in welfare through the extension of financial services. Addressing these areas will require a coordinated effort across institutions, product categories and market segments, in order to ensure that the underlying market inefficiencies are adequately addressed and the opportunities capitalized on. It will also require the government to work together with other stakeholders such as the private sector, development partners and sector experts.

To assist these stakeholders to address the opportunities in harmony, a MAP Roadmap is being discussed by the MAP Steering Committee. The roadmap will outline in further detail the programme of action necessary to address the identified priority areas.

9 Appendices

9.1 Appendix A: Derivation of priorities matrix

The potential demand/impact figures are derived from FinScope data as follows.

Products		Source
Credit	Personal loans	Borrowing drivers: living/emergency expenses
	Asset	Borrowing drivers: asset purchase
	Housing	Borrowing drivers: housing/land
	Productive credit	Borrowing drivers: business/agriculture
Savings	Retirement	Savings drivers: retirement
	Accessible/liquid savings	Savings drivers: non-medical emergency + living expenses
	Healthcare	Savings drivers: healthcare
	Education	Savings drivers: education
	Capital accumulation	Savings drivers: housing, land, farming, business
Payments	Payments	Proportion of target group spending money daily on food & drink
	Remittances	Remittance users
Insurance	Asset	Dwelling ownership, adjusted for insurance usage
	Health	Income shocks: illness / medical expenses
	Crop	Income shocks: insurable agricultural risks, adjusted for insurance usage; farming groups only
	Credit	Formal credit users
Financial literacy	Debt management	Borrowing perceptions: see someone for debt problems
	General	Barriers to financial services/products - lack of understanding
	Risk management	"Did nothing" in response to selected risk events
Consumer protection	Credit information	Formal credit users
	Market conduct	Users of banking/other formal

In all cases, figures are rounded to the nearest 5%.

9.2 Appendix B: list of literature

Autor	Title	Content used	Weblink /Reference
Asian Development Bank, 2015	Asian Development Outlook 2015	CONTEXT: Chapter on Laos with concise description and assessment of the macro economic development	Asian Development Outlook 2015
Bank of the Lao PDR Financial Institution Supervision Department. 2013	Micro-finance Statistics 2012	Only MFI	NERI MicrofinanceStatistics_2012_Eng
D'Hoore, Alain; Davading, Somneuk; Phimmahasay, Keomanivone. 2015.	Lao economic monitor : towards restoring macroeconomic stability and building inclusive growth. Washington, DC ; World Bank Group.	Macroeconomic data	WB Lao Economic Monitor 2015
Hogenhout, Timo H., for the Asian Development Bank, 2011	The rural and microfinance sector of the Lao People's Democratic Republic. Vientiane, Asian Development Bank	Valuable info about informal sector and remittances	ADB Rural & Microfinance Sector Lao 2011
International Finance	Lao PDR	CONTEXT: Excellent and	IFC Financial Sector Diagnostic 2007

Cooperation, 2007	Financial Sector Diagnostic 2007	concise information, but OUTDATED; use for reference REGULATIONS :	
Ministry of Planning and Investment, 2015	Five Year National Socio-Economic Development Plan 2016 - 2020, 5th Draft	CONTEXT	150225 Draft 8th NSEDP 2016-20
Ministry of Planning and Investment, 2011	The 7th Five-year National Socio-Economic Development Plan (2011-2015)	Context	Lao PDR - 7th NSEDP 2011-15 full version
World Bank, 2015	Doing Business - Going Beyond Efficiency - Economy Profile 2015 Lao PDR	Doing Business indicators incl. Access to credit	WB Doing Business 2015
Southichack, Mana, for Swiss Agency for Development and Cooperation, 2014	Lao Labor Migration and Remittance - Trends and economic and livelihood implications	Migrants	SDC Lao Migrant Workers Remittance 2014

9.3 Appendix C: list of interviews

Category	Name of organisation	Name and position of representatives	Website
Regulator/ Government	Bank of Lao, Financial Institutions Supervision Department, Legal Division	Ms Phayphet Chounlamounti, Vice Director Mr. Kikeo Boualapheth, Technician	www.bol.com.la
	Government's Office, Lao National Committee for Rural Development and Poverty Eradication, Rural Devpt & Poverty Eradication Department	Mr. Kongkeo Vongpaseuth, Director General	http://www.prflaos.org/
	Bank of Lao, Anti Money Laundering Unit	Ms Vilaiphone Sitthisone, Head of Supervision Division Nantha Phommavongsa, Head of Analysis Division	www.bol.com.la
	Ministry for Planning and Investment, Rural Development and Poverty Eradication Department	Mr. Lienthong Souphany, Dep. Director General Ms Pany Voulalachith, Economic Development Dep. Mr. Somxai Thammaphath, Deputy Head of Microeconomic Dep.	http://www.investlaos.gov.la/
	PMO, National Committe for RD&PE, Poverty Reduction Fund (Government Project)	Mr. Julien Rossard, Senior Advisor, Ms. Boualy Sayavong, Head of Finance and Admin Division	http://www.prflaos.org/
	Bank of Lao, Information Technology Department	Mr. Phanethong Kongvongsa, Acting Director General, Mr. Poutsala Omdala, Head Programm Division	www.bol.com.la
	Ministry of Labour and Social Welfare,	Mr. Padeumphone Sonthany, Director General	http://www.ssolao.gov.la/index.php?lang=en

	Social Security Organisation		
	Bank of Lao, Bank Supervision Department	Mr. Somphadith Volachith, Deputy Chief Legal Division	
Development Organisation / Project	World Bank	Mr. Evgenij Najdov, Country Senior Economist Ms. Vidaovanh Phounvixay, Finance & Market team	http://www.worldbank.org/en/country/lao
	UNCDF	Mr. Cedric Javary, International Technical Specialist	http://mafipp.org/
		Mr. David Kleiman, PHB Development Senior Consultant	
	Microfinance Association	Ms. Pamouane Phetthany, Director Mr. Alfred Gugler, Former Technical Advisor Ms. Phayvanh Saleumsouk, KM & Adm./Finance Ms. Savana Phothilath, CB & Advocacy	http://www.laomfa.org/
	Asian Development Bank	Mr Phantouleth Louangraj, Senior Economics Officer	http://www.adb.org/countries/lao-pdr/main
	DGRV	Mr Holger Grages, Country Director Ms. Jutta Rehag, Consultant Mr. Douangchan, MF Advisor	
	GIZ - Access to Finance for the Poor/Rural Finance	Mr. Thorsten Fuchs, Project Director, Mr. Bandith Sisoukda, Microfinance Senior Advisor Mr. Bilal,	
		Mr. Marc-André Zach, Senior Advisor Financial Literacy	
	SNV - Netherlands Development Organisation	Mr. Fransisco Tolentino, Senior Technical Advisor	

	KfW - German Development Bank	Mr. Lorenz Gessner	
Financial Services Providers	Agricultural Promotion Bank	Mr. Somphone Vongsavanh, Deputy Director Mr. Bounyou Meuangmahavong, Chief of Credit Division Ms. Thouda Thepsimeaung, Deputy of Int. Relations Division	http://www.apb.com.la/
	Lao Development Bank	Ms. Oudone Boulommavong, Head of IT Center Mr. Koumphan Sengchan, Deputy IT Mr. Kouangchan Phengsavanh, Technician Mobile Banking	http://www.ldblao.la/ldbeng/
	AGL Insurance	Mr. Guy Apovy, CEO Mr. Holady Volarath, Deputy Managing Director	http://www.agl-allianz.com/index.html
	Joint Development Bank	Mr. Sounthorn Chanthavong, Director General Mr. Khamhou Thongthavy, Deputy Manager	http://www.jdbbank.com.la/
	LaoVietBank	Mr. Ms. Chansada Phetsakdahouean, Int. Relations dep. Ms. Thonenaly Phanthavong, Customers relations Div, Mr.Veo Phouangsavath, Head of Customers Dep. Ms. Thipsavang Louanglat, Investment Dep,	http://www.lao-vietbank.com/default.aspx?lang=1
	Lao Telecom	Mr. Pawaris Iamam, Deputy Director General,	http://www.laotel.com/
	Nanyobay Bank	Mr. Sengchan Keosongseng, Dep General Director, Mr. Panyasavay Ratthasena, Head of Foreign Relations Dep., Ms. Phimphone Sengsoulinyavong, Dep Head Credit Department,	http://www.nbblao.org/ELVS/about_nbb.php

		Ms. Phettavong Thepphapim Financial Accounting dep.	
	Phongsavanh Bank Ltd.	Ms. Sengdao Bouphakhonekham, Managing Director, Mr. Southideth Nalivanh, Dep Managing Director, Mr. Bounthanh Vongsoury, Deputy Managing Director	http://www.phongsavanhbank.com/psv/index.php
	ACLEDA Bank Lao Ltd.	Mr. Narin Phon, Managing Director and CEO	http://www.acledabank.com.la/la/eng/
	Women and Family Development Fund	Ms. Khonevilay Sengsourinha Director, Mr. Bernd Werthenbach, Regional Coordinator SFBIC, Mr. Oliver Schuster Country Representative and Project Director SBFIC	
	For Development DTMFI	Mr. Khampasong Mounivong, Manager	
	Lao Postal Savings Institute	Mr. Nikone Outhatithith, Director, Mr. Somlith Damrongnamachanh, Deputy Director of Lao Postal Enterprise, Mr. Somexay Sanhaxeng, Deputy Director	
	Patoukham DTMFI	Ms. Khanmany Southammavong, Manager	

9.4 Appendix D: list and cornerstone data of banks as of December 2014

#	Name	Acronym	Origin of fund	Licensing year	No. Of branches	No. of service units (incl. FX)	No. Of ATM	Internet- banking	Loan Outstanding (LAK mio.)	Loan Loss Provision (LAK mio.)	Total Assets (LAK mio.)
	State-owned Banks										
1	Banque pour le Commerce Exterieur Lao	BCEL	GoL	1975	19	65	281	Yes	9,728,396	199,313	23,489,159
2	Lao Development Bank	LDB	GoL	2002	18	75	175	Yes	5,761,761	N/A	10,712,146
3	Agricultural Promotion Bank	APB	GoL	1993	17	87	71	No	3,600,375	696,105	4,530,485
4	Nayoby Bank	NBB	GoL	2007	10	65	n/a	n/a	2,294,600	-	2,818,840
Total					***64***	***292***	***527***	-	***21,385,132***	***895,418***	***41,550,630***
	Joint-Venture State Commercial Banks										
1	Lao-Viet Bank		GoL, GoV	1999	5	6	31	No	4,083,352	25,566	5,607,060
2	Banque Franco-Lao Ltd	BFL	BRED 54% BCEL 46%	2010	0	19	34		525,533	2,668	1,190,755
3	Lao China Bank Co., Ltd		GoL, GoC	2014	0	0	0		166,388	842	839,118
Total					***5***	***25***	***65***	-	***4,775,273***	***29,076***	***7,636,933***
	Private Banks										
1	Joint Development Bank	JDB	Lao	1989	0	19	65		513,024	4,119	1,079,827
2	Phongsavanh Bank Ltd		Lao	2007	4	21	60		1,468,645	22,143	2,458,748
3	ST Bank Co.,Ltd		Lao	2009	3	26	39	No	1,424,090	5,957	2,361,687
4	Indochina Bank Ltd		Korean	2008	2	6	25		2,257,893	16,092	3,146,612
5	Booyong Lao Bank Co., Ltd		Korean	2009	0	0	0		3,913	n/a	210,328
6	Lao Construction Bank Limited		China		0	1	3		140,877	300	387,814
7	Maruhan Japan bank PLC Vientiane branch		Japan	2013	0	0	2		64,192	320	289,043

#	Name	Acronym	Origin of fund	Licensing year	No. Of branches	No. of service units (incl. FX)	No. Of ATM	Internet- banking	Loan Outstanding (LAK mio.)	Loan Loss Provision (LAK mio.)	Total Assets (LAK mio.)
Total					***9***	***73***	***194***	-	***5,872,634***	***48,931***	***9,934,059***
	Subsidiary Banks										
1	ANZ Bank (Lao) Ltd			2007	0	0	21	Yes	665,226	18,726	1,264,724
2	ACLEDA Bank Lao Ltd		Cambodia	2008	9	31	44		687,210	24,453	1,172,872
3	International Commercial Bank Lao Ltd		Malaysia	2008	2		3		489,005	8,679	950,398
4	RHB Bank Lao Ltd		Malaysia	2014	0	0	0	n/a	81,233	406	344,070
Total					***11***	***31***	***68***	-	***1,922,674***	***52,264***	***3,732,064***
	Foreign Commercial Bank Branches										
1	Bangkok Bank Pcl, Vientiane Branch		Thailand	1993	0	0	0		285,312	8,039	1,037,533
2	Krung Thai Bank Pcl, Vientiane Branch		Thailand	1993	0	0	0		10,055,617	50,278	10,426,979
3	Bank Of Ayudha pcl, Vientiane Branch		Thailand	1994	0	0	0		210,692	2,107	535,299
4	TMB Bank Public Company Limited		Thailand	1993	0	0	0		22,283	1,552	159,243
5	Siam Commercial Bank pcl Vientiane Branch		Thailand	1992	0	0	0		22,044	110	349,707
6	Public Bank Vientiane Branch		Malaysia		0	0	1		989,574	6,416	1,417,085
7	Public Berhad Bank Ltd, Sikhai Branch		Malaysia		0	0	1		204,840	1,520	271,898
8	Public Berhad Bank Ltd, Savannakhet Branch		Malaysia		0	0	1		163,775	917	227,181
9	Bank Of Ayudha pcl, Savannakhet Branch		Thailand	2009	0	0	0		105,567	1,056	200,236
10	Military Commercial Joint Stock Bank - Lao Branch		China	2011	0	0	0		192,987	1,182	323,687
11	Industrial and Commercial Bank Of China Limited Vientiane Branch		China	2011	0	0	0		9,413,530	2,151	12,854,422
12	Vietin Bank Lao Branch		Vietnam		0	0	2		108,737	3,769	281,954
13	Saigon-Hanoi Commercial Joint Stock Bank-Lao Branch		Vietnam	2012	0	0	0		476,105	4,694	740,914

#	Name	Acronym	Origin of fund	Licensing year	No. Of branches	No. of service units (incl. FX)	No. Of ATM	Internet- banking	Loan Outstanding (LAK mio.)	Loan Loss Provision (LAK mio.)	Total Assets (LAK mio.)
14	Public Bank Pakse Branch		Malaysia		0	0	1		84,834	618	124,599
15	May Bank Branch		Malaysia	2002	0	0	2		204,262	1,022	2,207,737
16	CIMB Thai Bank Vientiane Branch		Thailand	2014	0	0	0		-	-	124,696
17	Cathay United Bank Vientiane Capital Branch		Taiwan	2014	0	0	0		N/A	N/A	N/A
18	Saigon Thuongtin Commercial Joint stock bank Lao Branch (Sacom Bank)		Vietnam	2008	1	2	0		557,504	303	864,731
19	Bank of China Limited Vientiane branch		China		0	0	0		N/A	N/A	N/A
20	First Commercial Bank LTD, Vientiane Branch		China		0	0	0		N/A	N/A	N/A
Total					***1***	***2***	***8***	-	***23,097,663***	***85,734***	***32,147,901***

9.5 Appendix E: list and cornerstone data of microfinance institutions (MFIs) and leasing companies as of December 2014

	Name of institution	Province of operation	Origin	Year of license	Assets (LAK mio.)
	Special License				
1	Lao Postal Savings Institute	Vientiane/ country-wide	public	2000	
	Deposit Taking Microfinance Institutions				
1	Ekphattana DTMFI	Vientiane	private	2006	51.200
2	Newton DTMFI	Vientiane	private	2007	9.663
3	Saynyaisamphanh DTMFI	Savannakhet	private	2009	81.101
4	Saynhai Samphanh DTMFI (Khammouane Branch)	Khammouane	private	2010	With 3
5	Champa Lao DTMFI	Luang Phrabang	SCU	2009	10.183
6	Sengaly Microfinance DTMFI	Vientiane	private	2010	n/a
7	Borkham Chaleunsab SNP DTMFI	Vientiane	private	2010	3.851
8	DTMFI for Development	Vientiane	SCU	2010	13.461
9	Patukham DTMFI	Vientiane	private	2012	3.497
10	Development DTMFI	Vientiane		2013	2.215
11	Nakhoneluang DTMFI	Vientiane		2012	2.807
12	Phonevaly DTMFI	Vientiane		2012	1.252
13	Women and Family Development DTMFI	Vientiane	FS project /LWU	2012	12.901
14	Xokxai DTMFI	Vientiane		2014	n/a
	Non-deposit-taking Microfinance Institutions				
1	Development Microfinance Institution Phongsaly	Phongsaly	RD project	2006	21.028
2	Cooperative Credit and Saving Association Hongsa-Nguenh	Sanyabouly	RD project, VB apex	2006	3.099
3	Village Development Fund Association Bokeo	Bokeo	RD project, VB apex	2005	236
4	Cooperative Credit and Saving Association Khop-Xienghon	Sanyabouly	RD roject, VB apex	2008	1.314
5	Oudomxay Development NDTMFI	Oudomxay	FS project	2008	7.864
6	Suaykan Pattana NDTMFI	Huaphan	LWU	2009	970
7	Hom NDTMFI	Vientiane		2009	543
8	Mitmaity NDTMFI	Khammouane		2009	1.126
9	Xayniyom NDTMFI	Oudomxay	RD roject, VF apex	2010	27.693
10	Kaumvangmai NDTMFI	Vientiane		2011	275
11	Sasomsab NDTMFI	Vientiane		2011	2.709
12	Thavixap NDTMFI	Attapeu	RD roject, VB apex	2012	1.066
13	Homxabphathana NDTMFI	Luang Namtha	RD roject, VB apex	2011	2.837
14	Vilabouly Dankham NDTMFI	Savannakhet	RD roject, VB apex	2013	1.677
15	Phothisane NDTMFI	Vientiane		2012	1.078
16	Xayoudom NDTMFI	Vientiane		2012	210

17	Houngheungxab NDTMFI	Luang Phrabang		2012	923
18	Chanthavong NDTMFI	Khammouane		2012	1.002
19	Hongkeo NDTMFI	Vientiane		2012	1.119
20	Souphaphone NDTMFI	Saravan		2012	1.063
21	Next NDTMFI	Vientiane		2013	1.237
22	Oudom Aek NDTMFI	Vientiane		2013	1.177
23	Jetlarnzub NDTMFI	Vientiane		2013	604
24	Alounmai NDTMFI	Vientiane		2013	883
25	Mahasab NDTMFI	Oudomxay		2013	n/a
26	Mani NDTMFI	Vientiane		2010	3.844
27	Chanchaleun NDTMFI	Saravan		2014	n/a
28	Saleumsouk NDTMFI	Vientiane		2014	958
29	Thavixok NDTMFI	Vientiane Province		2014	n/a
30	Netibandith NDTMFI	Vientiane		2014	960
	Savings and Credit Unions				
1	Fonds Cooperative	Vientiane	Farmers' organisation	2004	10.597
2	SCU Vientiane	Vientiane province		2004	336
3	SCU Seno	Savannakhet	project	2008	7.125
4	SCU Louang Phrabang	Luang Phrabang	project	2004	5.807
5	SCU Thakhek	Khammouane		2008	1.691
6	SCU Houamchai Phattana	Savannakhet	LWU	2008	4.600
7	SCU Paksong	Savannakhet		2008	986
8	SCU Huasae Chaleun	Champasack		2008	4.502
9	SCU Thoulakhom	Vientiane Province	project	2009	n/a
10	SCU Mittaphap	Vientiane		2009	1.451
11	SCU Vanhmai	Saravan	project	2010	739
12	Nonghaikhok Development SCU	Champasack		2011	6.062
13	SCU Phonngam	Luang Phrabang		2011	n/a
14	SCU Namthouam Tai	Luang Phrabang	Former VF	2011	n/a
15	SCU Xiengmouak	Luang Phrabang		2011	716
16	SCU Houyyangkham	Champasack		2011	3.327
17	SCU Development Keosamphanh	Champasack		2011	1.693
18	SCU Khonchanh	Luang Namtha	project	2012	1.890
19	SCU Phonsavan	Luang Phrabang		2012	n/a
20	SCU Phonsavang	Luang Phrabang		2012	n/a
21	Senechalern Donekong Saving and Credit Development Corporative	Champasack		2013	n/a
22	Pakthone 4 Zone Development Fund NEW	Bolikhamxay	BoL		n/a
	Staff Savings Institutions				
1	Bank of Lao Saving	Vientiane	staff	1995	n/a
2	ETL Saving	Vientiane	staff	2005	n/a

Specialised Leasing Companies					
1	Mayda Leasing Company	Vientiane		2009	
2	Thanasab Leasing and Finance Ltd.	Vientiane		2010	
3	Sisombath Leasing	Vientiane		2011	
4	Houamphatthana Leasing Ltd.	Vientiane		2011	
5	Laothongkeo Leasing Ltd.	Vientiane		2011	
6	Mahatheunh Leasing Ltd.	Vientiane		2012	
7	An Leasing Ltd.	Vientiane		2013	
8	Aeon Leasing Ltd.	Vientiane		2013	
9	Phiouvongsaene Leasing Ltd.	Vientiane		2013	
10	Phongsak Leasing Ltd.	Vientiane		2013	
11	Lanexang Leasing Ltd.	Vientiane		2013	
12	Sabaidee Leasing Ltd.	Vientiane		2014	
13	Krungsi Leasing Ltd.	Vientiane		2014	
14	Xabkhanna Leasing Ltd.	Vientiane		2014	
15	Lao-Asian Leasing Ltd.	Vientinane		2014	
16	BS Capital Lao Leasing Ltd.	Vientinane		2014	

9.6 Footnotes

[1] Ministry of Public Work and Transport 2014: Road network statistics 2014
[2] United Nations 2015
[3] See http://www.gallup.com/poll/154625/ southeast-asian-leaders-earn-highest-job-approval-asia.aspx
[4] According to FinScope, 93% of adults have a Family Book for identification, and 52% have national ID cards.
[5] Prime Minister Instruction 01/PM, 2000
[6] Stuart-Fox, 2006.
[7] Internet source 7
[8] Internet source 16
[9] Vientiane Times, 28/4-2015, p.3
[10] Vientiane Times, 5/6-2013.
[11] Southichack, 2014.
[12] Lao National Statistics Bureau, 2005.
[13] Internet Source 11
[14] World Bank, 2015
[15] Ministry of Planning and Investment, 2011.
[16] World Bank, 2014.
[17] Stuart-Fox, 2006.
[18]World Bank, 2015.
[19] Dalaloy, 2015.
[20] Ministry of Planning and Investment, 2015.
[21] World Bank, 2015
[22] Interviews with banks
[23] Not included here is direct lending to state-owned enterprises by the central bank itself, that in 2012 accounted for 79% of lending to state-owned enterprises (Spantig, w/o.y.).
[24] FinScope 2015.
[25] Bank of the Lao PDR, 2015.
[26] FinScope 2015.
[27] FinScope 2015 and Lao Statistical Bureau, 2006.
[28] ADB, ARF, ASEAN, CP, EAS, FAO, G-77, IAEA, IBRD, ICAO, ICRM, IDA, IFAD, IFC, IFRCS, ILO, IMF, Interpol, IOC, IPU, ISO (subscriber), ITU, MIGA, NAM, OIF, OPCW, PCA, UN, UNCTAD, UNESCO, UNIDO, UNWTO, UPU, WCO, WFTU (NGOs), WHO, WIPO, WMO, WTO
[29] Source 6.
[30] World Bank, 2015.
[31] Source 6.
[32] For details, see https://atlas.media.mit.edu/en/profile/country/lao/
[33] Source 8.
[34] Unfortunately, FinScope did not cover the aspect of ethnic affiliation.
[35] Decree on Associations, No. 115/PM 2009
[36] A Chinese banana investor in Louang Namtha is quoted to say that 'local people are too rich to work on plantations' Source: Shi, Weiyi, 2015
[37] Lao National Statistics Bureau, 2014
[38] Lao Statistics Bureau, 2014
[39] Law of the Bank of Lao PDR, No 5/NA, 14 Oct 1995
[40] World Bank, 2015a.
[41] One SOB (LDB) and 3 foreign bank branches were not reporting.
[42] NERI, 2015.
[43] Lao Viet Joint Venture Bank, Banque Franco-Lao Ltd., Lao China Bank Ltd. and Lao-Viet Insurance Joint Venture Company
[44] Vientiane Times, 8/7-2015
[45] Notice No. 634/PM, 21 Oct 2009.
[46] Regulation on Loan Classification requirement for Commercial Banks which are under the Supervision of the Bank of the Lao PDR No 6/BOL, 11 May 2004.
[47] Performance data across sectors cannot be directly compared due to different data sources, quality of data and different methods of calculation. The different categories of financial providers operate with widely differing objectives and under different conditions, that also reflect on their performance data.
[48] 88% in 2013 (NERI, 2015)
[49] EMI has with great success mobilised children as savers, targeting schools by setting up classroom savings groups and promoting financial literacy. Payroll credits are the business essence of the Saynyaisamphanh DTMFI. Grameen-based group lending methodology has been successfully introduced to Laos by the Women and Family Development Fund and the Xay Ni Nyom NDTMFI.
[50] GIZ. 2015. 72% of respondents named 'the bank' as the safest place to keep one's money.

[51] 2 DTMFI, 4 NDTMFI and 7 SCU
[52] There are numerous names used for community-based financial institutions in Laos: For non-deposit taking funds, typically Village Revolving Fund, Village Fund and Village Development Fund are used, although the latter terma are also used for deposit-taking funds. The terms Savings Fund, Village Savings and Credit Group and Village Bank indicate their character as deposit-taking. In this document, all these funds, unless specifically distinct by the context, are named under one 'Village Funds'.
[53] Typically 70% of the profit is distributed as dividend on savings aka shares, with the remaining 30% paid as remuneration for committee and external support (if any), for general reserve and social funds within the village fund.
[54] Instructions No. 05/PM, 4 Apr 2007, and No. 19/PM, 5 Sept 2013; in Champassak province, the Provincial Governor has issued a further instruction based on the first PM instruction: No. 07/PGCH, 27 Apr 2011.
[55] Source: Qualitative research interviews in villages in Oudomxai and Champassak provinces.
[56] Paksan, Mounlapamok and Soukhouma districts, Champassak province
[57] In Khammouane and Savannakhet provinces; SNV - Netherlands Development Organisation 2012.
[58] Shi, Weiyi 2015
[59] A third, Coinstar Money Transfer Ltd., has only one agent.
[60] Interview with Mr. Somphone Sisenglath, 29/5-2015
[61] Interview with CEO Mr. Guy Apovy, AGL Insurance
[62] $PAR_{>30}$ per 31/3-2015 for all Village Banks was 6,7%
[63] Sayaboury Microfinance Office, Sihom Project Savings and Credit Scheme and Oudomxay Development NDTMFI
[64] Interview with Ms. Fongchinda Sengsourivong, Deputy Director General, Bank of Lao, Monetary Policy Department, 27/5-2015
[65] Government of Laos, 2003 p. 118ff.
[66] Ministry of Planning and Investment, 2011
[67] Funded by ADB/IFAD/SDC.
[68] No 5/NA, 14 Oct 1995
[69] Law on Commercial Banks, No 6/NA, 26 Dec 2006
[70] Regulation on Interest rates setting, No. 529/BoL, 21 July 2015
[71] Decree on the Implementation of the Commercial Banks Law, No. 275/PM, 25 Sep 2009.
[72] JDB and BFL have only service units, and no branches at all.
[73] Regulation No. 529/BoL, 21 July 2015
[74] Regulation No. 361/BOL, 23 April 2012
[75] Notice 663/BoL, 21 Jul 2015 and Notice 705/BoL, 1 Aug 2015
[76]'The Nation' online edition 6/8-2015: Banks in Laos cut interest rates to boost production
[77]'Notice on Strengthening Efficiency of Credit Portfolio Management, No. 311/BSD, 2 June 2010
[78] Decree on Microfinance Institutions, No 460/PM, 3 Oct 2012
[79] Regulation for Savings and Credit Unions, No 3/BOL, 3 Jun 2008
[80] National Economic Research Institute, 2015.
[81] Interview with Mr. Somphone Sisenglath, Director of Ekphatthana MFI, 29/5-2015
[82] Some requirements for microfinance institutions are based on the draft version of the Microfinance Decree Guidelines that were available at the time of the mission; they can be subject to change in the final version.
[83] Notice 1806/FISD, 27 Nov 2014
[84] Similar restrictions are valid for leasing companies: All leasing companies are presently operating from Vientiane, because they need to prove 2 years' profitable operation before being allowed to open branches in the provinces.
[85] No. 5/PM, 4 Apr 2007 and No.19/PM, 5 Sep 2013
[86] Flaming, M., 2010, p.2.
[87] Microfinance Decree No 460/PM, 3 Oct 2012.
[88] Motor vehicles, hotels, guesthouses, entertainment places, restaurants, markets, construction sites, warehouses, chemical warehouses, fuel warehouses, explosive substance warehouses, factories, land, navigation and air transportation of goods and passengers, fire and places for producing and storing explosive substance
[89] Decree on Anti-Money Laundering No. 55/PM, 27 Mar 2006; Guidelines on Anti Money Laundering Procedures and Operational Controls of Reporting Institutions under Supervision of the Bank of Lao PDR, No. 2/BOL, 16 Sep 2008
[90] In beforehand, every Lao national has to be registered at the local police office of her residence, documented by the Family Registration Booklet; based on the Family Registration Booklet, national ID cards are issued for persons that intend to leave their home district, and passports to persons with intentions to travel abroad.
[91] Interview of Ms Vilaiphone Sitthisone, Head of Supervision Division, Anti Money Laundering Unit, Bank of Lao, 8/5-2015
[92] Instruction No. 231/BFSD, 2 July 2007
[93] Regulation No. 752/BOL, 30 Nov 2007
[94] Flat interest rate loans calculate interest based on the initial credit amount regardless any repayment of principal in installments. It significantly increase the cost of credit (a rule of thumb is that it doubles it if principle is to be repaid in equal amount at each installment) over a calculation based on declining balance that reflects the nominal interest rate.
[95] Regulation No. 04/BOL, 20 June 2008; Notice No. 231/FISD, 22 Feb 2013; Notice No. 1177/FISD, 10 Sep 2013; Notice 1711/FISD, 24 Dec 2013.
[96] Regulation No. 256/BOL, 24 May 2007

[97] Regulation on Protecting Soundness Practices among of the Commercial Banks and Financial Institutions which are under the supervision of the Bank of the Lao PDR, No. 4/BoL, 15 Jan 1996
[98] Where not specifically mentioned, the source of information in chapter 5 and 6 is FinScope 2014 for quantitative data, and the author himself for additional context information.
[99] Boike Rehbein, states that the majority of Lao adhere to ‚subsistence ethics', a term shaped to describe the economic culture especially of Southeast Asian peasant societies. „Their interest is focused on having enough until the next harvest, not on accumulating as much as possible. (...) For them, survival and security are the goals of economic action, not affluence and profit." (Rehbein, Boike. 2007. Globalization, Culture and Society in Laos. P. 54).
[100] Rehbein, Boike. 2007. Globalization, Culture and Society in Laos.
Stuart-Fox, M.. 2006. *Asian Studies Review, March 2006, Vol. 30, pp. 59–75*
[101] Personal experience and information from discussions with numerous practitioners.
[102] GIZ 2015.
[103] FinScope 2014
[104] However, a large part of village or community funds in Thailand have been classified as 'formal', while all village funds in Laos are 'informal'.
[105] By taking the size of the income into consideration, respondents that had not specified their income, were excluded from further analyses.
[106] The extremely high indebtedness of low-income self-employed groups is one of FinScope's unexpected outcomes. It will be analysed further.
[107] Group interview 14/7-2015 B. Nongbouathong, Mounlapamok district, Champassak province
[108] In the AFP study on Financial Literacy, only 4% mentioned that they were saving in order to earn interest (GIZ 2015).
[109] No amounts were stated for borrowing from MFI and SCU, hence not represented in this graph.
[110] GIZ 2015.
[111] Notice 663/Monetary Policy Dep. 21 Jul 2015 and Notice 705/Monetary Policy Dep. 1 Aug 2015. The official justification was to stimulate investment by lowering the interest rate. However, credit interest has so far not been effected.
[112] Examples: The ACLEDA Bank is using microfinance approaches successfully. The APB branch in Oudomxai deploys a mobile team – 2 staff on a motorbike – to collect savings in the provincial suburbs.
[113] Like the use of piggy banks or children savings accounts in other cultures.
[114] SNV 2012.
[115] However, this may over-estimate the relevant debt/income ratio, as in many cases it will be *household* income that is relevant for debt-servicing purposes, whereas this measures simply *individual* income
[116] Amongst others: Kemp, Melodie. No year.
[117] Vientiane Times, 28/4-2015
[118] In Paksong district, Champassak province, 11/7-2015.
[119] GTZ-HRDME 2009.
[120] MFI and SCU not represented in this graph.
[121] 'If they want interest, they are not family!', as an interviewee put it (Group interview at new ITECC, 9/6-2015). However, in Champassak province (Group interview Paksong, 15/7-2015), there were reports of interest-bearing family loans.
[122] Personal remark Mr. Bandith Sisoukda, 27/4-2015
[123] as documented by Lao National Statistics Bureau 2014.
[124] Vientiane Times, 12/7-2015: NA concludes on socioeconomic development: '*NA members called on the Bank of Lao PDR to enhance its guidance of Nayoby Bank in revising its loan structure to release loans to the real producers, especially farmers, while penetrating each family rather than releasing large amounts of money to an individual or individuals.*'
[125] Internet Source 6.
[126] The land management offices issue temporary land certificates and permanent land titles. This process is presently extended nation-wide.
[127] Flat rate loans calculate the interest based on the initial loan balance, without regard to a possibly declining balance in case of repayment in installment. As a result, the effective interest rate for loans with declining balances is higher than the nominal interest rate.
[128] FinScope 2014
[129] It is reported to be common practice in the banking sector, and especially at SOB, that good connections or financial rewards have a positive influence on loan processing. ACLEDA builds its reputation on transparency and zero-tolerance towards bribes.
[130] EMI is using 3.5% per month flat rate for SME loan at the minimum of LAK10 million. The declining rate will apply for all loan products to loan sizes LAK10.5 million and above.
[131] SNV - Netherlands Development Organisation. 2012.
[132] Loan term not stated.
[133] Qualitative research interviews with villagers in B. Phouthong and B. Pangsa, Namo district, Oudomxai province (9/7-2015), and B. Nonnyang, Soukhouma district and B. Nongbouathong, Mounlapamok district, Champassak province (14/7-2015)
[134] APB and NBB disburse loans with assistance from district staff, especially staff from the Agricultural and Forestry Office.

[135] ACLEDA has previously organised short training courses on SME and credit management for new customers, EMI DTMFI has a significant educational component for its child clients in cooperation with Aflatoun, DGRV has in the past organised village theater for Village Bank communities, GIZ's Village Bank NSOs do trainings in financial literacy in their member Village Banks.
[136] FinScope 2014
[137] Southichack 2014.
[138] 54,135 foreign workers of which 39,127 were registered and 15,008 not registered
[139] The servicing costs of such ATMs are often shared between the bank and the factory
[140] Interview (29/5-2015) with Mr. Somphone Sisenglath, Managing Director of Ekphatthana Deposit-taking Microfinance Institution that once pursued the specific business model to cater for Lao migrants to Thailand
[141] https://www.giz.de/en/downloads/giz2015-en-assessing-financial-literacy-rural-areas-laos.pdf
[142] even though this is not enforced: only 50% of cars and 55% of motorbikes are reported to be covered by an insurance scheme (Interview with Mr. Guy Apovy, CEO AGL Insurance, 7/5-2015)
[143] Interview with Mr. Padeumphone Sonthany, Director General, Ministry of Labour and Social Welfare, Social Security Organisation
[144] This study found at least one such provider.
[145] Helms, Birgit, 2006: Access for All: Building Inclusive Financial Systems. The International Bank for Reconstruction and Development / The World Bank.
[146] FinScope 2015.
[147] Informal interviews in B. Phouthong and B. Pangsa, Namo district, Oudomxai province, 10/7-2015
[148] The APB in Oudomxai collects savings on a daily basis by sending a mobile team on a motorbike into the suburbs. ACLEDA and LDB are collecting credt in installments from their clients rather than waiting for them to come to the office.
[149] Which is at least 10% p.a. (Interview with Mr. Lorenz Gessner, KfW - German Development Bank, 20/5-2015).
[150] Interview with World Bank representatives, 30/4-2015
[151] Sanyasamphanh DTMFI
[152] A decree on pledging of moveable assets for collateral. Registration and web-based access to information are under preparation.
[153] A widespread misunderstanding of the needs of rural people and subsequent overestimation of credit demand arises when outsiders preparing for a project come to ask villagers for their problems and needs: 'Money' will be a very common answer. The glad interviewer interprets this into 'oh, they need credit', and proposes a credit component, just for the project to experience that the credit component fails either because of poor repayment or, if the project takes a strong stand on credit discipline, of low actual demand. However, the villagers didn't mean credit, they just identified the low level of asset and income as a major constraint.