

**Xiengkhouang Agricultural Development Project Phase II
IFAD Loan: 491 LA**

Rural Financial Services Review Report



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Dr. Gene Octavio
Somphone Sisenglath
Rural Financial Services Consultants

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
APB	Agricultural Promotion Bank
BOL	Bank of Lao PDR
GDP	Gross Domestic Product
FGD	Focus Group Discussions
IAS	International Accounting Standards
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
Lao PDR	Lao People's Democratic Republic
LWU	Lao Women's Union
MDG	Millennium Development Goal
MFI	Microfinance Institution
MOAF	Ministry of Agriculture and Forestry
MOF	Ministry of Finance
MIS	Management Information System
NERI	National Economic Research Institution
NPEP	National Poverty Eradication Programme
PFU	Programme Facilitation Unit
PPFU	Provincial Programme Facilitation Unit
RMFC	Rural and Microfinance Committee
SM	Supervision Mission
SME	Small and Medium Enterprise
SOCB	State-owned Commercial Bank
SOE	State-owned Enterprise
TA	Technical Assistance
TOR	Terms of Reference
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNODC	United Nations Office on Drugs and Crime
UNOPS	United Nations Office for Project Services
US Dollars	United States Dollars
VRF	Village Revolving Fund
XK	Xieng Khouang

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EXECUTIVE SUMMARY

1. The Consultancy assignment was performed from 21 October to 20 November 2004. Work was done in Xiengkhouang Province in coordination with the Xiengkhouang Agricultural Development Project - Phase II), APB Xiengkhouang Branch,) and Xiengkhouang Lao Women's Union or LWU, with full support of the UNODC and UNDP. The Consultancy Team, composed of an International Rural Financial Services Consultant and a National Rural Financial Services Consultant was stationed at the APB Xiengkhouang Branch in Phonsavanh township.

2. In the first quarter of 2004, UNOPS SM Report on Loan 491-LA (Xiengkhouang Agricultural Development Project – II) strongly recommended a conscious effort to include the poorest, the poor and upland communities in all project activities. It also stressed the fact that the “poor are not lazy”, as proven by IFAD projects elsewhere, thus, recommending further that such thinking about the poor should be discouraged.

3. Particular to the Rural Financial Services component of the Project¹, the SM recommended the recruitment of an RFS expert to assist in developing a strategy to: (i) include in the Project the poorer categories of borrowers (especially in upland areas), (ii) ensure sustainability of the loan scheme beyond the Project life (including a clear outline of rules and procedures for future on-lending), (iii) improve repayment performance, and (iv) outline a clear strategy for promoting and mobilizing savings, among other things. Moreover, it called for increased collaboration with the LWU to provide credit, (particularly short-term loans) to women.

4. Thus, given the background scenario with its attendant issues and concerns, the UNDP-UNODC defined the terms of reference (TOR) for this one-month assignment as follows:

- Conduct a thorough review of the APB loan scheme and outline a clear strategy for promoting and mobilizing savings for the poorer categories of borrowers, especially in the upland areas;
- Identify constraints/gaps/problems of the existing system and procedures as well as their solution; and,
- Suggest ways to streamline the process, system and procedures of granting loans to saving groups consisting of the poorest, poor and women particularly those in the upland communities of target project villages.

5. In order to fulfil the TOR for this assignment, the Consultants utilized both data collection and data analysis procedures. Three main procedures for data collection were used in this short-term study. These are (i) key informant interviews or KII, (ii) focus group discussions or FGD, and (iii) secondary data review. Data analysis was performed using situational analysis (including analysis of problems and issues) and solutions analysis further utilizing tools of analysis such as percentages, pie chart, bar graph and tables. Thus, both quantitative and qualitative data were analyzed.

¹ The Project being referred in this report refers to the UNODC-IFAD Xiengkhouang Agricultural Development Project Phase II.

6. The findings in this study can be grouped into (i) quantitative and (ii) qualitative information. APB Xiengkhouang Branch provided almost all of the data used in this study. The quantitative data mostly included APB loan disbursement of IFAD funds by type of loan, use of loan, interest rates charged, district disbursements and loan repayments, including NPLs². Savings data included amounts saved and interest rates by savings products. Perhaps, more important to this Project, are the qualitative or non-quantifiable variables such as quality of group formation, maintenance of credit discipline, loan recovery techniques, mobilizing savings among low-income groups, financial services targeting, and training/capacity-building of potential clients, and APB-LWU staff.

7. Three types of loan were provided by APB Xiengkhouang to clients in the province. These were (i) short-term loans with a maturity period of one year or less, (ii) medium-term loans of between 1 and 3 years maturity, and (iii) long-term loans with 3 to 5 years maturity. These loans were charged 20%, 22% and 24% interest rates, respectively. Moreover, current loan portfolio exposure by loan term showed more loan funds were extended for medium- and long-term loans. In microfinance practice, low-income borrowers tend to borrow short-term loans of smaller sizes which are easy for them to utilize and repay. Whereas, not-so-poor borrowers prefer larger loans with longer maturities. This implies that in Xiengkhouang, it is possible that IFAD-sourced loan funds were lent to non-poor clients. However, the team was not able to verify this through a deeper study due to time limitation.

8. Loans were used for various purposes. Most common uses of loans included: (i) purchase of female water buffaloes, (ii) fishpond culture, (iii) cattle-raising, and (iv) land clearing. These are mostly medium and long-term loans, and not the kind of loans preferred by low-income families. LWU women-clients in one Phaxai village, for example, preferred marketing loans for buying and selling water buffaloes. The dominance of medium and long-term loans in APB lending could be attributed to bank strategy of spreading its portfolio over time. In other words, to remain in the banking business, a continuous inflow of interest income and principal repayments over the years could be assured with long-term vs. short-term loans. Gender-wise, handicrafts (weaving) most commonly performed by women were financed quite weakly (only Kip 55 million) compared with over Kip 700 million extended for purchase of female water buffaloes. This, however, may be due to lower demand for handicraft loans than for other types of loans. Again, an in-depth analysis of actual demand for specific loan types was not possible given the limited time to conduct the study. In a seminar presentation held at UNDP at the end of the review, it was further suggested that cost-benefit analysis of potential investment opportunities including agri-based enterprises could be conducted as this would help the APB and other lenders in appraising loan applications and in deciding which ones are more profitable for bank financing.

9. A whopping 43% of APB XK loans are classified as non-performing loans (NPLs). It is about Kip 1.8 billion and is roughly equivalent to 167,000 USD. In clarifying this observation with APB XK Management, it was found that the figure

² The issue of non-performing loans (NPLs) as included in this study was later on qualified and explained further by the APB XK Management. It was claimed that these NPLs consisted not only of past due loans or loans which have already matured but remained unpaid, but also loans that are at risk, meaning loans whose periodic interest payments (three consecutive payments) have been missed by the borrower.

includes loans that still have to mature but are nonetheless regarded as “portfolio-at-risk”, which means that the borrowers of such loans have failed to make three consecutive payments on their loan interest charges to the bank, thus, risking the full repayment of the loan principal even at maturity. The APB, through the Asian Development Bank (ADB) Restructuring Plan hopes to resolve this problem which is associated with NPLs. The overriding principle in treating NPLs is to avoid sending delinquent borrowers to jail, or settle disputes in the court which is considered a costly exercise. Loan restructuring as well moral suasion are the APB’s preferred measures to handle the NPL problem.

10. Loan delinquency has been found to be related to (i) district location, (ii) loan term, and (iii) use of loan. District-wise, data showed that loan delinquency was more pronounced in three districts (Pek, Phaxai and Kham) which are adjacent to the provincial APB branch office located in Phonsavanh, the capital and commercial center of the province. Secondly, the data also revealed that short-term loans were much better repaid than medium and long-term loans. Thirdly, loans that were used for trading and small animal raising (pigs, poultry) were better repaid than loans utilized for land clearing, fishpond culture, etc. For example, one farmer in Kham district who borrowed Kip 16 million is unable to settle his medium-term fishpond loan obligations with the bank and is now considered delinquent.

11. The above phenomenon supports the observation in other countries wherein loans extended to borrowers at or near the center of development and commerce tend to repay poorly than those in more remote areas. For one thing, clients in semi-urban and commercial centers have varied sources of income. They also have physical collateral to back up loan obligations. Therefore, since they have alternative sources of financing or collaterals to offer, they may opt not to pay back their loans with the bank. But among the truly hard working poor whose only source of loan may be the IFAD fund, repayment may be high as they tend to protect their credit standing with the bank. Repaying the first loan means that they can borrow again, even without collateral. The Group liability or peer pressure (social collateral) serves as their guarantee with the bank in lieu of physical collateral. But for the well-off clients who are residing closer to the bank branch, not paying their loans with the bank does not necessarily penalize them as they have other assets to back them up or they have other sources of financing for their businesses. The problem is exacerbated if these loans (IFAD loans) were perceived as “grant money”. In the case of the non-poor accessing loan funds intended for the poor, and at the same time absconding on their loan repayment obligation, real benefits accrue to the non-poor, and to the detriment of the whole poverty-reduction project.

12. Given the above observations and preliminary interpretation of the quantitative data from APB, it is implied that in order to improve the repayment performance of APB XK branch, the bank may need to re-focus their lending towards clients residing in districts away from Phonsavanh center. These districts include Khoun, Phoukout and Nonghet. In the same vein, APB needs to aggressively recover the delinquent loans in Pek, Phaxay and Kham districts. Secondly, APB may have to re-constitute its loan portfolio by allocating and targeting more short-term lending than medium and long-term lending. By doing both (lending to clients in far away villages and providing more short-term loans), APB can be assured of better repayment

performance and contribute significantly to poverty reduction and rural development via accessible and sustainable rural and micro finance services.

13. On APB XK's savings mobilization performance, currently it provides 5 savings products to its customers in the province. These are (i) ordinary savings account, (ii) 3-month time deposit, (iii) 6-month time deposit, and (iv) 12-month time deposit. They earn interests at 6% p.a., 8% p.a., 9% p.a. and 10% p.a., respectively. The minimum amount to open an ordinary savings account is Kip 5,000 and Kip 20,000 for the others. As of 30 September 2004, APB XK had a deposit intake of about Kip 9.3 billion, whereas its loans outstanding as of the same period was only Kip 5.3 billion. This implies that APB is not able to convert its savings into loan funds for lending to clients in Xiengkhouang province. Bank management admits this difficulty, and the problem is partly due to certain limitations and regulations from the Head Office. The current Restructuring Plan being implemented by ADB with APB will have an effect on APB branch's ability to perform genuine financial intermediation now and in the future. This needs to be monitored and followed up.

14. The lending scheme utilized for IFAD loans follows the group lending approach although loans are disbursed to individual clients under group guarantee. In summary, the whole process from group formation to loan monitoring and repayment includes the following steps: (i) group formation, (ii) loan application, (iii) loan appraisal, (iv) loan approval and loan contract preparation, (v) signing the loan contract, (vi) loan disbursement, (vii) opening accounts with the bank, (viii) loan use monitoring, and (ix) loan principal and interest payment recovery. Currently, the APB XK lending scheme is rather conventional and lengthy. Unless it innovates in its lending operations, and allowed by the Head Office to do so, in relation to its role in poverty reduction through IFAD loans, it would be a long way for APB to be an effective institution for agricultural and rural development.

15. Gender Segregated Data and Role of Women. While IFAD-UNOPS SM consistently recommended the targeting of women as loan and savings clients of the bank, the APB XK Branch has not yet come up with a record-keeping system that clearly identifies clients by gender. Thus, it cannot be clearly understood whether XK women borrowers repay better than men borrowers. The LWU provincial head also acknowledged that in the Lao context and due to the traditional culture, men still makes the decision with regard to making a loan with the bank, although paying it back becomes the obligation of the whole family and the wife could sign the loan application form with the husband. APB XK agreed to modify their loan applications to accommodate gender-related issues, and reported that they are now having more women as borrowers.

16. Positive Attributes of the Poor and Women. The meetings also brought up issues concerning the poor and women. Some of these include: (i) the poor are not lazy, (ii) the poor repay their loans better than the non-poor, (iii) women make use of their loans better than men and honor their loan obligations, (iv) women have strong capacity for group formation and cohesion, and (v) women undertake multiple roles in family management, rearing of children as well as in managing and running micro businesses.

17. The study had pinpointed several problems, issues, difficulties and weaknesses in the APB XK's system of lending and saving in general, and the attempts at

providing the poorest, the poor and the women among them, access to rural and micro finance services in particular. These problems and issues were extracted from project documents, reports and interviews³ and were classified in this study based on (i) perception bias and prejudices, (ii) gender, (iii) bank policies and practices, (iv) Lao Women's Union's institutional weaknesses and limitations, (v) client behaviour and perception, and (vi) project-linked problems.

18. Most of the field problems could have been offshoots of overall bank policy of the APB at the head office and APB XK may not be in a position to address them easily at the provincial level. APB may need to be guided by specialized policies and provided with extra logistical support to enable them serve the rural and micro finance needs of poorer clientele in the province compatible with the wishes of IFAD. It was also evident in the study that poor group formation was the cause of many problems particularly non-repayment and misuse of loans. Group formation tends to be rushed especially when loans have to be disbursed based on quota targets. This can have long-term detrimental effects on the program. Rushed group formation can miss the basic principles of effective group formation which are hinged on (i) self-selection of group members by the villagers themselves, (ii) careful vetting of potential members, (iii) choosing members with similar socio-economic standing in the village, (iv) grouping with members of same gender, and (v) not having members closely related by blood, up to the third degree of consanguinity, to be in the same group. Of course, in the Lao context, some room for adjustment can be made without sacrificing group quality and discipline. However, the role of the village chief in vetting and in providing moral pressure especially in regard to repayment is likewise important.

19. Some of the group formation-based solutions may include: (i) adequate social preparation of the poor and potential women borrowers, which may include adult non-formal education or training in numeracy and literacy, (ii) effective group formation--not rushed, no close relatives, gender sensitive, socio-economic homogeneity, (iii) effective training on group member responsibilities and lending-saving discipline, and (iv) careful choice of members through vetting. These should precede any actual loan disbursement to the poorest, poor and women clientele. Such scheme works in many Asian countries targeting poor women as microfinance clients and with sustainable results.

20. Furthermore, the study suggests the following measures to promote lending and saving among the poorer sectors: (i) formulating a set of alternative banking policies, procedures and practices for this group of clientele and get these implemented by formal financial institutions (through a microfinance window or unit) which believe in microfinance as an effective poverty reduction instrument, (ii) setting up an alternative banking institution mainly for the poor and women and other disadvantaged groups with their existing microenterprises, (iii) promoting private initiatives towards the creation of microfinance institutions that would cater to the microfinancial needs of low-income groups and of women microentrepreneurs, and (iv) strengthening the

³ These reports include UNOPS Supervision Mission Report, March 2004 and Rural Financial Advisor-Dr. Mana Southichack's Report, 2000. Other problems were raised during key informant interviews with the APB, LWU and Project offices located in Phonsavanh, while field visits to Kham, Nonghet and Phaxai districts elicited various problems and difficulties encountered by village clients, village heads, and field staff of APB, LWU and the UNODC-IFAD Project.

capacity of existing organizations or agencies such as the Department of Finance in Oudomxay and Sayaboury which have pioneered in microfinance operations since 1998. These could be expanded and replicated in other provinces especially in poorer districts in order to reduce poverty substantially before year 2015.

21. The study likewise suggested enterprise-based solutions such as lending to clients with combined short and long-gestating enterprises or those with both non-farming activities such as petty trading that generate cash earnings in a shorter period, and farming enterprises that usually generate cash in a longer period. Non-farm goods and services would enable the borrower to have cash at regular short intervals. Part of this cash earnings can be used to make amortized loan repayments with the bank. A number of bank and policy-based solutions were also forwarded. These include (i) streamlining bank procedures, (ii) clarifying bank policies, vis-à-vis IFAD policies, and (iii) having pro-active and innovative banking culture with aggressive and dedicated field staff. APB may also develop the following: (i) aggressive collection scheme, (ii) innovative savings products, (iii) consistent terms and conditions, (iv) interest rate that covers costs, and (iv) effective staff training courses. Some of the microfinance best practices the bank can adopt to improve its repayment performance may include the following: (i) proper group formation and training, (ii) provision of small loan size for first-time borrowers, (iii) small regular repayments of loan principal, (iv) short-term lending for poor clients, and (v) close monitoring and supervision.

22. Client-based solutions to the problems elicited from interviews and documentary research would zero in on the creation of credit discipline among the borrowers through a thorough value-reorientation beginning at group formation stage. Such values to be inculcated among the low-income clients may include personal discipline as it relates to repayment, hard work and creditworthiness. Among clients with limited production and income-generating skills, training may be necessary before loans are extended to them. On the other hand, institution-based solutions may include (i) provision of attractive benefits and provisions to APB and LWU field staff who have direct contact with low-income clients, (ii) increased investment in human resource development through training and skills-upgrading courses, (iii) forging an agreement between LWU and APB at the central, provincial and district levels towards closer coordination, communication and complementation of activities (especially at the district and village levels) to ensure that overlaps and misunderstanding are prevented from happening. The main goal is to deliver microfinancial services to the poor and women in a coherent and synchronized manner.

23. Given the nature of this short-term consultancy, the following recommendations are being forwarded:

- Establish a microfinance window of APB
- Pilot MF best practices in a poor district
- Increase social and physical infrastructure in poor and remote areas
- Strengthen group formation mechanism
- Support the APB-ADB restructuring plan, whenever necessary, especially as it supports outreach to low-income but enterprising rural population
- Transfer back to APB Xieng Khouang Branch the IFAD II and UNODC loan funds that were remitted to APB Head Office in Vientiane, for the re-use of

low-income farmers in Xieng Khouang province especially those in Nonghet district who have shifted from opium production to alternative livelihood activities.⁴

The above-listed suggestions and recommendations are geared towards improving the capability of APB to service the rural and micro finance needs of low-income groups of people in Xieng Khouang province with the long-term objective of reducing rural poverty.

⁴ It is further suggested by the Team that a formal request and follow up be made by UNODC-IFAD Project with APB Head Office in Vientiane to resolve this issue, copy furnished to the APB XK management.

I. INTRODUCTION

1 In the first quarter of 2004, UNOPS undertook a supervision mission (SM) for the Xiengkhouang Agricultural Development Project Phase II¹. One major finding of this SM showed that the rural financial services (RFS) component was amiss in some respects. First, it could have contributed to improving the socio-economic status of poor women if only loans were targeted deliberately at them. Second, although a significant amount of loans has already been disbursed, access by the poor and the poorest among them, has been quite limited due to the conditions set by the financial institution. Third, the SM also noted that the "savings mobilization program which was envisaged at project appraisal, has not been effectively implemented".

2 In the light of these findings, the UNOPS SM recommended a consultancy work that would "support the Agricultural Promotion Bank (APB) in (i) re-orienting its overall savings and credit program, and (ii) improving access to financial services by the key target groups, e.g., poor, poorest, and women, especially those in upland communities. The SM noted, in particular, "that no improvement has been made" in the RFS component "despite recommendations of the last Supervision Mission". Therefore, given these findings and recommendations of the UNOPS SM, the current UNODC-UNDP Consultant Team was tasked to (i) review the APB loan scheme and outline a clear strategy for promoting and mobilizing savings especially among poor borrowers including those in upland areas, (ii) identify constraints/gaps/problems of existing systems and procedures and their solutions, and (iii) streamline the process, systems and procedures of providing loans to target groups.

3 The Consultancy assignment was performed from 21 October to 20 November 2004. Work was done in Xiengkhouang Province in coordination with Dr. Bounpone (NPD of the Xiengkhouang Agricultural Development Programme Phase II), Mr. Phonxay (Manager of APB Xiengkhouang) and Mrs. Khampoui (Administrator of Xiengkhouang Lao Women's Union or LWU) as supported by the UNODC and UNDP. The Team, composed of Dr. Generoso G. Octavio (International Rural Financial Services Consultant) and Mr. Somphone Sisenglath (National Rural Financial Services Consultant) was stationed at the APB Xiengkhouang Branch in Phonsavanh township.

II. BACKGROUND OF THE ASSIGNMENT

4 UNOPS Supervision Mission Report. The 2004 UNOPS SM Report on Loan 491-LA (Xiengkhouang Agricultural Development Project – II) had strongly recommended a conscious effort to include the poorest, the poor and upland communities in all project activities. It also stressed the fact that the "poor are not lazy", as proven by IFAD projects elsewhere, thus, recommending further that such thinking about the poor should be discouraged.

5 Particular to the Rural Financial Services component of the Project², the SM recommended the recruitment of an RFS expert to assist in developing a strategy to:

¹ For details on this SM, please see Reference No. 7.

² The Project being referred in this report refers to the UNODC-IFAD XK ADP Phase II.

(i) include in the Project the poorer categories of borrowers (especially in upland areas), (ii) ensure sustainability of the loan scheme beyond the Project life (including a clear outline of rules and procedures for future on-lending), (iii) improve repayment performance, and (iv) outline a clear strategy for promoting and mobilizing savings, among other things. Moreover, it called for increased collaboration with the LWU to provide credit, (particularly short-term loans) to women.

6 Other RFS-related Recommendations. The Project was further tasked by the UNOPS SM to comply with the Appraisal Report guidelines for issuing future loans, namely: (i) effective group formation, (ii) formalization of mandatory savings requirements, and (iii) increasing the interest recovery rate. The SM recommended to APB and PPMU to cease providing loans to individual farmers. Instead, future loans should be provided only to members of mature groups of 10-15 farmers, “with clear emphasis on women membership and savings”. In addition, the SM required that future lending to non-project villages would only be undertaken upon approval of the Provincial Steering Committee (PSC), copied to UNOPS, and only after APB has clearly demonstrated that the (i) village meets the profile of project’s target village, and that the (ii) poor and poorest in the target villages no longer have the capacity to further absorb subsequent credit. In all cases, priority would be first accorded to project target villages.

7 Year 2000 Consultancy Report on APB-IFAD. In a study of APB Xiengkhouang branch operations and services which was conducted in 2000, the following issues and observations were raised: (i) high credit risks due to concentration in “female water buffalo loans” and “too little marketing loans” made outside Pek District³, (ii) “forced” savings on bank bonds at 7% annual interest rate in a high inflation rate regime “is a bad deal for borrowers”, (iii) mismatch between rural development goal and bank service expansion when it comes to project village targeting, and the need for bank service office in difficult villages, (iv) weak district-level coordination and cooperation between LWU and APB, (v) problematic interest rate structure which charges low rates for long-term loans and high rates for short-term loans, (vi) limited district-level offices and staff, (vii) few loans extended to women borrowers, and (viii) limited personnel skills and modern tools. These issues along with others which were highlighted in the course of this short-term mission are discussed at length in the Sections on Problems and Solutions Analysis.

8 Policy Statement for the Development of Sustainable Rural and Micro Finance Sector. As drafted by the Rural and Micro Finance Committee (RMFC) in August 2003, the policy statement raises some high hopes for the resolution of the issues and problems cited above. Among the statements agreed to by the committee include the following: (i) RMF services are able to mobilize savings and enhance effective use of funds that can contribute to living condition improvement and poverty reduction among Lao people, (ii) most of RMF methodologies are suitable to the needs of the Lao people, (iii) some pilot Lao microfinance initiatives are successful and can become sustainable, and (iv) potential demand for such services is very high.

9 UNODC-IFAD-APB Rural Finance and the NPEP. It is interesting to note that the role of rural and micro finance has not been incorporated in the National

³ Pek District covers the immediate vicinity where the APB Xiengkhouang Branch Office is located.

Poverty Eradication Programme (NPEP), in spite of the widely-recognized contribution of rural and micro finance as an effective instrument in reducing rural poverty among less-developed countries worldwide. Perhaps, it is high time to include rural and micro finance as components of poverty-reduction strategies since any-income generating activity would require financing—either through loans (debt) or own capital (equity) or a combination of both. Besides, microfinance provides not only self-employment but also jobs to family members and their neighbors. Increases in income and employment opportunities certainly reduce poverty.

10 Definition of Poverty in the Lao Context. Identifying a common poverty measure for Lao PDR is rather difficult due to a complex cultural and ethnic diversity, as well as the wide dispersion of poor villages in inaccessible areas and wide variations in livelihood and income-generating activities across rural, semi-urban and urban settings. Thus, in 25 June 2001, the Lao Government, through the Prime Minister's Instruction No. 010 attempted to define poverty as ..."lack of essential needs of daily life such as the lack of food (inability to provide 2,100 calories per person per day), the lack of clothing, the lack of permanent accommodation, the inability to afford fees for medical treatment in case of illness, the inability to afford payment for education of members of the family and the lack of conditions for convenient communications." It is worth noting that in this definition, the lack of productive resources such as land and capital amongst the poor are excluded. Development experience has proven that self-employment made possible by small amount of capital (microloan) is a powerful tool to reduce poverty. It could generate surplus income that enables a poor family to access food, clothing, housing, medication, education and transportation/communication facilities.

11 In relation to the Millenium Development Goals for Lao PDR, between 1990 and year 2015, the Lao PDR is expected to reduce poverty by half, that is, from the implied level of 48 percent (1990) to about 24 percent by year 2015. As a long term goal, the Lao Government is aiming at graduating the country from the status of being one of the "least – developed countries" in the world. The role of microfinance towards achieving this national goal on poverty reduction does not need to be overemphasised. The UNDP has recognized microfinance as "one of the key driving mechanisms toward meeting the MDGs, specifically the overarching target of halving extreme poverty and hunger by 2015."

III. TERMS OF REFERENCE AND OBJECTIVES

12 As stated in the Consultants' terms of reference (TOR) for this one-month assignment, the following are the required activities and outputs:

- Conduct a thorough review of the APB loan scheme and outline a clear strategy for promoting and mobilizing savings for the poorer categories of borrowers, especially in the upland areas;
- Identify constraints/gaps/problems of the existing system and procedures as well as their solution; and,
- Suggest ways to streamline the process, system and procedures of granting loans to saving groups consisting of the poorest, poor and women particularly those in the upland communities of target project villages.

IV. METHODOLOGY

Data Collection Procedure. Three main procedures for data collection were used in this short-term study. These are (i) key informant interview or KII, (ii) focus group discussions or FGD, and (iii) secondary data review.

13 Key Informant Interviews (KII). Officials of the APB, LWU and UNODC-IFAD projects in Xieng Khouang province were interviewed. These interviews with key officials were conducted at their headquarters in Phonsavanh. Moreover, interviews with APB staff assigned in Phaxai, Nonghet and Kham districts were likewise conducted. At the village level, village chiefs were consulted with regard to the APB lending operations which at times focused on the utilization of the IFAD-sourced loans.

14 Focus Group Discussions (FGD). Three districts were chosen for field studies. These were Phaxai, Nonghet and Kham districts. Arrangements for FGDs between the village APB borrowers/clients and the Consultants were made prior to the visits. These visits were facilitated by the APB staff assigned in those districts. The FGD in Phaxai was conducted before lunch at the temporary temple (*wat*). It was attended by about 30 women-borrowers and a handful of men including the village head. The women borrowers consisted of two groups. The first group are the traders who are mostly engaged in buying and selling water buffaloes, while the second group consisted of those who are doing handicrafts and weaving with the use of handlooms.

15 Review of reports and documents. Immediately upon commencing the assignment, the Consultants were provided with project documents (e.g., Xieng Khouang Agricultural Development Project Report-Phase II Appraisal Report), UNOPS Supervision Mission Report, Consultancy Report on APB-IFAD Loan, and other materials and publications from UNDP and the Bank of Lao PDR (BOL). The APB Phonsavanh Branch also provided the Team with relevant credit and loan recovery data and other pertinent information which the Team needed for the study. These reports and documents provided the Consultants with initial background information about the UNODC-IFAD projects as well as a helpful understanding of the problems encountered in the projects in relation to rural financial services provision, loan recovery, targeting and savings mobilization.

Analytical Procedure. Three main analytical procedures were employed in this short-term study. These were as follows: (i) Situational Analysis, (ii) Problems Analysis, and (ii) Solutions Analysis. Analytical tools used included (i) simple tabular analysis, (ii) use of averages, percentages, growth rates, graphs and flow charts, and (iii) descriptive analysis. The use of more sophisticated and rigorous analytical procedures was not possible given the very short duration of the assignment and data limitations. Nevertheless, given the nature and scope of the terms of the reference and the expected output from the study, it was deemed that the procedures utilized above were sufficient enough to warrant a substantive study.

V. FINDINGS (Situational Analysis)

A. Quantitative Data

16 The findings in this study can be grouped into (i) quantitative and (ii) qualitative information. APB Xiengkhouang Branch provided almost all of the data used in this study. The quantitative data mostly included APB loan disbursement of IFAD funds by type of loan, use of loan, interest rates charged, district disbursements and loan repayments, including NPLs⁴. Savings data included amounts saved and interest rates by savings products. Quantitative data included those that pertain to group and individual lending, lending by gender, lending by income levels or economic status (poorest, poor, non-poor) or even by topography (highland, midland, lowland). Perhaps, more important to this Project, are the non-quantifiable variables such as quality of group formation, maintenance of credit discipline, loan recovery techniques, mobilizing savings among low-income groups, financial services targeting, and training/capacity-building of potential clients, and APB-LWU staff. Since the village heads are also given an important task in group formation (see Appendix 2), micro finance training should likewise be extended to them.

17 APB Loan Types. Three types of loan were provided by APB Xiengkhouang to clients in the province. These were (i) short-term loans with a maturity period of one year or less, (ii) medium-term loans of between 1 and 3 years maturity, and (iii) long-term loans with 3 to 5 years maturity. These loans were charged 20%, 22% and 24% interest rates, respectively. (See Table 1).

Table 1. APB Loan Types (IFAD II Loan)

Term	Duration	Interest rate IFAD Loan
Short term	< or = 1 year	20%
Medium term	between 1 and 3 years	22%
Long term	between 3 and 5 years	24%

18 Current loan portfolio exposure by loan term showed more loan funds were extended for medium- and long-term loans. (See Table 2 and Figure 1). This could be explained in part by the lending scheme adopted by APB in the early stages of the Project. According to APB XK Management, previous interest rate structure was

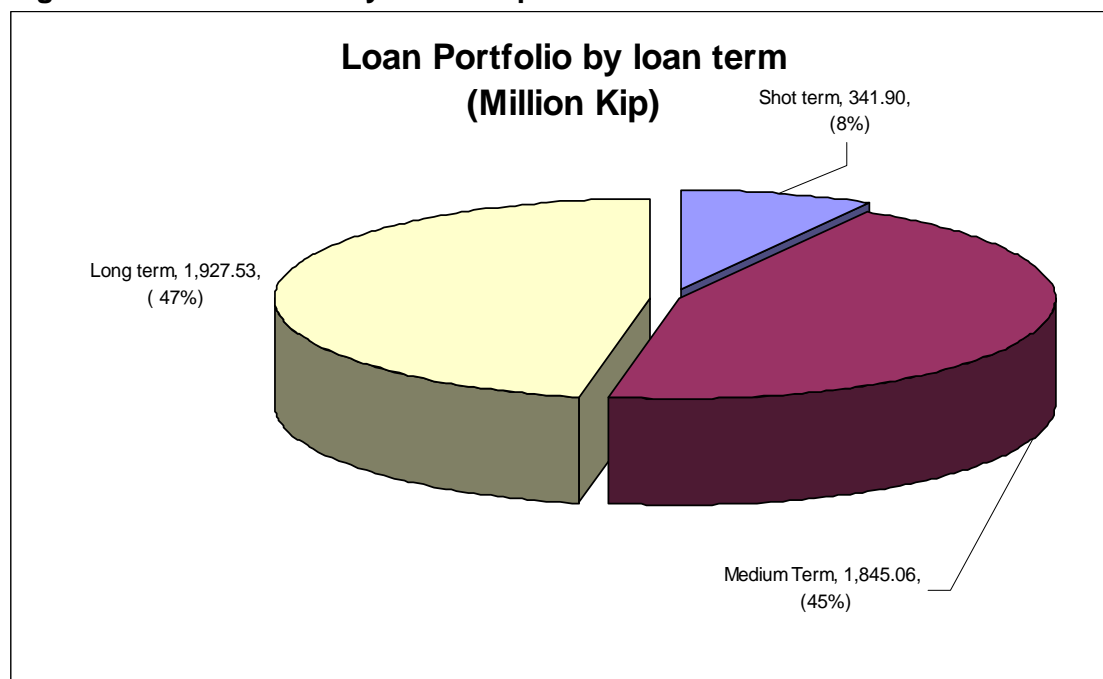
⁴ The issue of non-performing loans (NPLs) as included in this study was later on qualified and explained further by the APB XK Management. It was claimed that these NPLs consisted not only of past due loans or loans which have already matured but remained unpaid, but also loans that are at risk, meaning loans whose periodic interest payments (three consecutive payments) have been missed by the borrower.

reversed, meaning short-term loans were being charged with higher interest rates than long-term loans. This resulted to more clients opting to borrow larger volumes of medium- and long-term loans than short-term loans in response to the lower prices of the former loan types. In effect loan portfolio exposure of APB XK was concentrated on medium and long-term loans. In microfinance practice, low-income borrowers tend to borrow short-term loans of smaller sizes which are easy for them to utilize and repay. Whereas, not-so-poor borrowers prefer larger loans with longer maturities. This implies that in Xiengkhouang, it is possible that IFAD-sourced loan funds were lent to non-poor clients. However, the team was not able to verify this phenomenon with a deeper study due to time limitation.

Table 2. Current Loan Portfolio by Loan Term
(As of 12 November 2004)

Term	Loan Outstanding (Kip)
Short term	341,904,500
Medium term	1,845,062,000
Long term	1,927,532,000
Total	4,114,498,500

Figure 1. Loan Portfolio by Loan Purpose



19 Use of Loans. Loans were used for various purposes. Most common uses of loans included: (i) purchase of female water buffaloes, (ii) fishpond culture, (iii) cattle-raising, and (iv) land clearing. (See Table 3). These are mostly medium and long-term loans, and not the kind of loans preferred by low-income families. LWU women-clients in one Phaxai village, for example, prefer marketing loans to buy and sell water buffaloes. The dominance of medium and long-term loans in APB lending could be attributed to bank strategy of spreading its portfolio over time. In other words, to remain in the banking business, a continuous inflow of interest income and principal repayments over the years could be assured with long-term vs. short-term loans. Gender-wise, handicrafts (weaving) most commonly performed by women were financed quite weakly (only Kip 55 million) compared with over Kip 700 million extended for purchase of female water buffaloes. This, however, may be due to lower demand for handicraft loans than for other types of loans. Again, an in-depth analysis of actual demand for specific loan types was not possible given the limited time to conduct the study. In a seminar presentation held at UNDP at the end of the review, it was further suggested that cost-benefit analysis of potential investment opportunities including agri-based enterprises could be conducted as this would help the APB and other lenders in appraising loan applications and in deciding which ones are more profitable for bank financing.

Table 3. Loan Portfolio by Loan Purpose
(As of 12 November 2004)

	Loan Purpose	Loan (Kip)
1	Land clearing	297,516,500
2	Fishpond culture	470,747,500
3	Production equipment	-
4	Goat-raising	34,000,000
5	Cattle	343,600,000
6	Female buffaloes	724,550,000
7	Hand tractors	95,153,600
8	Small irrigation	-
9	Rice mill	-
10	Layers (Poultry)	-
11	Pig-raising	67,580,000
12	Fencing	14,305,000
13	Handicrafts	55,200,000
14	Marketing (trading)	143,700,000
15	Fruit tree plantation	78,400,000
16	Agricultural products trading	26,600,000
17	Others NPL/1992	1,763,345,900
	Total	4,114,698,500

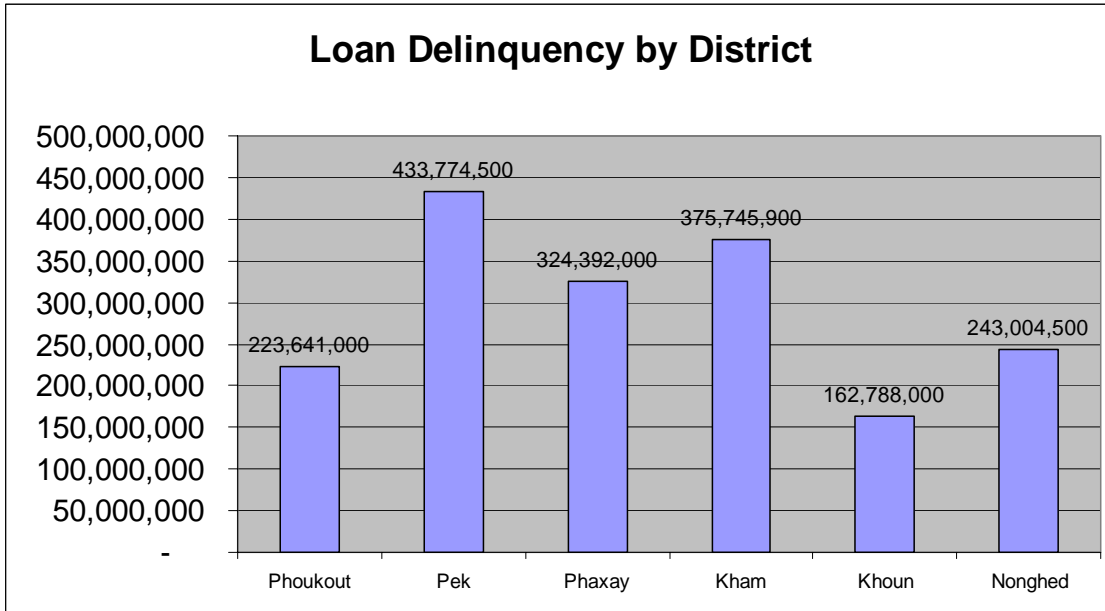
20 Loan Delinquency. Observing the current loan delinquency situation of APB XK, it is worth noting that a whopping 43% of loans are classified as NPLs. It is about Kip 1.8 billion and is roughly equivalent to 167,000 USD. In clarifying this observation with APB XK Management, it was found that the figure includes loans that still have to mature but are nonetheless regarded as “portfolio-at-risk”, which means that the borrowers of such loans have failed to make three consecutive

payments on their loan interest charges to the bank, thus, risking the full repayment of the loan principal even at maturity. The APB, through the Asian Development Bank (ADB) Restructuring Plan hopes to attack this problem. This Plan incorporates a scheme of resolving the problem associated with NPLs. The overriding principle in treating NPLs is to avoid sending delinquent borrowers to jail, or settle disputes in the court which is considered a costly exercise. Loan restructuring as well moral suasion are the APB's preferred measures to handle the NPL problem.

21 District-wise, loan delinquency was more pronounced in three districts which are adjacent to the provincial APB branch office located in Phonsavanh. (See Figure 2). Phonsavanh is the capital and commercial center of the province. Pek, Kham and Phaxay districts which are heavily burdened with delinquent loans are situated much closer to the APB Branch office than the other districts (Khoun, Phoukout and Nonghet). The paradox is that while Pek, Kham, and Phaxay are closer to the APB branch office, their repayment records with the bank are quite low and problematic. Moreover, borrowers residing in or close to the commercial center (which is Phonsavanh in Pek district) have access to better roads, markets, the bank and communication facilities. Theory would dictate that given the close proximity and accessibility to the bank, borrowers would be in a better position to repay as the burden of extra transaction costs e.g., transportation, would be lesser than for those in more remote districts and villages. Besides, APB staff can easily follow up and serve repayment notices to borrowers who live closer to the bank branch office. But why the poor repayment performance of these districts which are closer to the APB branch office? Perhaps, APB has to modify its lending scheme by targeting their loan portfolio to villages and districts which are away from the "center of development" or away from Phonsavanh. As bank data show, loan repayment is better in districts located farther away from the APB branch office. It is also in remote districts where the needy and poor are to be found.

22 The above phenomenon supports the observation in other countries wherein loans extended to borrowers at or near the center of development and commerce tend to repay poorly than those in more remote areas. For one thing, clients in semi-urban and commercial centers have varied sources of income. They also have physical collateral to back up loan obligations. Therefore, since they have alternative sources of financing or collaterals to offer, they may opt not to pay back their loans with the bank. But among the truly hard working poor whose only source of loan may be the IFAD fund, repayment may be high as they tend to protect their credit standing with the bank. Repaying the first loan means that they can borrow again, even without collateral. The Group liability or peer pressure (social collateral) serves as their guarantee with the bank in lieu of physical collateral. But for the well-off clients residing closer to the bank branch, not paying their loans with the bank does not necessarily penalize them as they have other assets to back them up or they have other sources of financing for their businesses. The problem is exacerbated if these loans (IFAD loans) were perceived as "grant money". In the case of the non-poor accessing loan funds intended for the poor, and at the same time absconding on their loan repayment obligation, real benefits accrue to the non-poor, and to the detriment of the whole poverty-reduction project.

Figure 2. Current Loan Delinquency



APB Branch of Office and Sub-services Unit map in Xiengkhouang province



23 Loan Delinquency by Loan Term. Consistent with the observation on loan delinquency by district, medium- and long-term loans registered much higher levels of non-repayment than short-term loans. (See Table 4). Earlier, it was noted that APB had disbursed more medium and long-term loans. This implies two things. One is the possibility that APB extended loans to non-poor borrowers as more well-off clients prefer medium and long-term loans of larger sizes or amounts. The poor seldom borrow large loans. The poor also prefer short-term loans over long-term

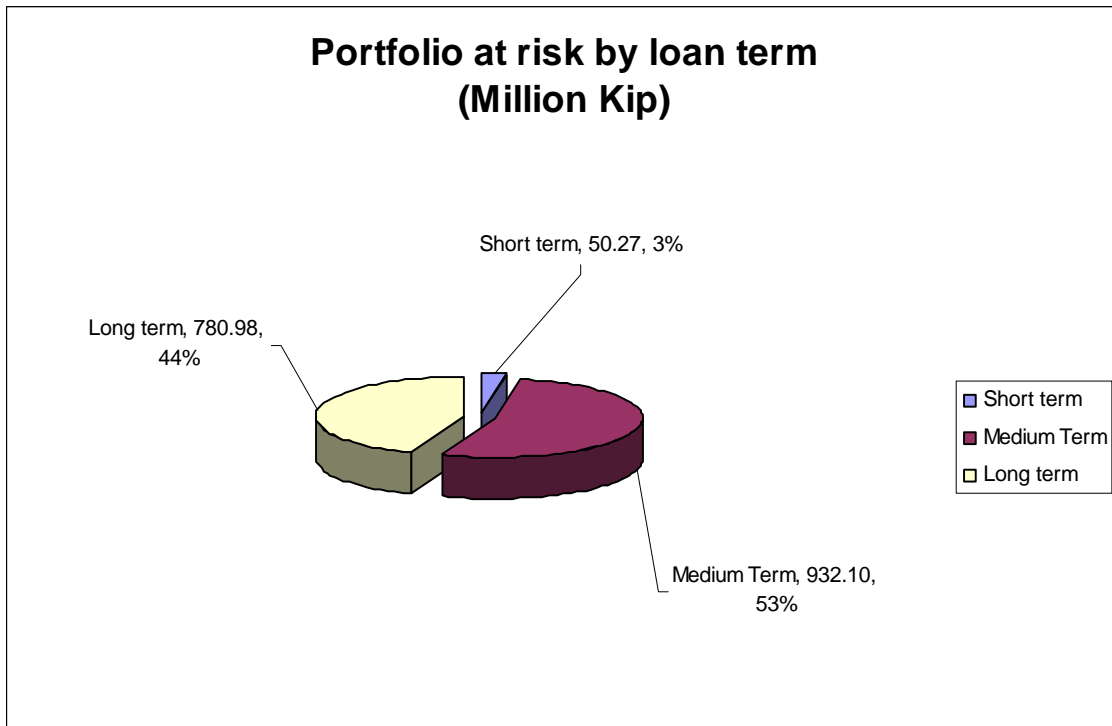
loans. Secondly, it is possible that most of the medium- and long-term loans were borrowed by clients who reside in districts close to the APB branch office. In view of limited time to go deeper into the study of correlating delinquency with loan term, district of residence, and wealth status, the secondary data provided by the provincial APB branch clearly indicate that (i) short-term loans have higher repayments over medium and long-term loans, and (ii) districts away from the APB branch office have higher repayments over those which are far away from it. By virtue of association, (poor borrowers prefer short-term loans over long-term loans; poor clients are mostly found in more remote areas), implied in the data, therefore, is the possibility that the loan portfolio of the APB were extended to mainly non-poor borrowers found in more accessible districts and whose loans were mostly of the large-sized medium- and long-term loans. Of course, in the absence of rigorous data collection and analysis, no hard conclusions can be made in this very short study.

24 Given the above observations and preliminary interpretation of the quantitative data from APB, it is implied that in order to improve the repayment performance of APB XK branch, the bank may need to re-focus their lending towards clients residing in districts away from Phonsavanh center. These districts include Khoun, Phoukout and Nonghet. In the same vein, APB needs to aggressively recover the delinquent loans in Pek, Phaxay and Kham districts. Secondly, APB may have to re-constitute its loan portfolio by allocating and targeting more short-term lending than medium and long-term lending. By doing both (lending to clients in far away villages and providing more short-term loans), APB can be assured of better repayment performance and contribute significantly to poverty reduction and rural development via accessible and sustainable rural and micro finance services.

Table 4. Loan delinquency by loan term

Term	Percentage	Delinquency by Loan term(Kip)
Short term	3%	50,268,500
Medium term	44%	932,095,400
Long term	53%	780,982,000
Total	100%	1,763,345,900

Figure 2. Portfolio-at-risk by loan term



25 APB XK Savings Mobilization Performance. Currently, APB XK provides 5 savings products to its customers in the province. These are (i) ordinary savings account, (ii) 3-month time deposit, (iii) 6-month time deposit, and (iv) 12-month time deposit. They earn interests at 6% p.a., 8% p.a., 9% p.a. and 10% p.a., respectively. The minimum amount to open an ordinary savings account is Kip 5,000 and Kip 20,000 for the others. (See Table 5).

Table 5. Current Types of Savings

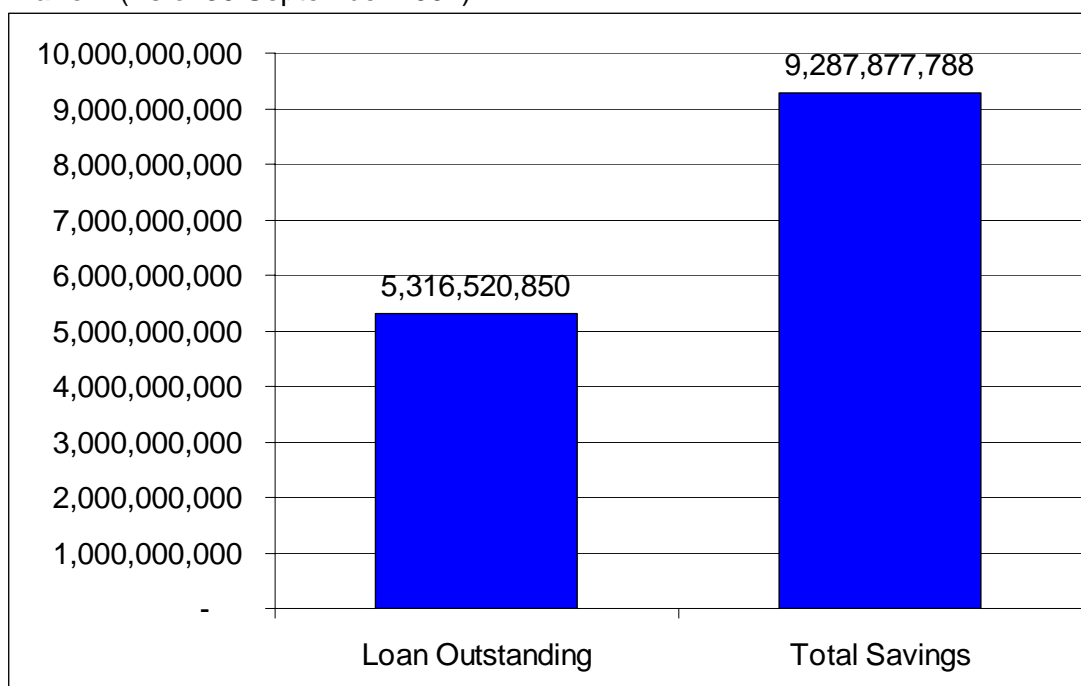
Savings Product	Minimum amount (Kip)	Interest rate
Savings	5,000	06%
3- month TD	20,000	08%
6- month TD	20,000	09%
12-month TD	20,000	10%

26 APB Mobilized Savings and Loans Extended. Table 6 shows the amount of savings the APB was able to mobilize from its customers in Xieng Khouang province. As of 30 September 2004, it had a deposit intake of about Kip 9.3 billion, whereas its loans outstanding as of the same period was only Kip 5.3 billion. This implies that APB is not able to convert its savings into loan funds for lending to clients in Xiengkhouang province. Bank management admits this difficulty, and the problem is partly due to certain limitations and regulations from the Head Office. To be an

effective and efficient financial intermediary, APB needs to transform the savings generated by its branch and sub-service units into loans that can be borrowed by farmers, traders and micro entrepreneurs towards rural development in the province. However, as is commonly practised even in other countries, banks like APB remit part of the savings it has mobilized in the countryside to the head office in the city for investment in more high-yielding ventures. The current Restructuring Plan being implemented by ADB with APB will have an effect on APB branch's ability to perform genuine financial intermediation now and in the future. This needs to be monitored and followed up.

27 A cursory study of the savings performance of APB XK was limited by several factors such as (i) lack of sufficient time to look into savers' profile (IFAD or non-IFAD savers, poor or non-poor, district distribution, gender dis-aggregation, size of savings, etc.), (ii) bank secrecy policy, and (iii) lack of classified records on savings. Nevertheless, the Consultants acknowledge the full cooperation of the APB XK management and staff in providing as much information as possible to substantiate the requirements of the short-term review.

Table 6. Savings compared to loan portfolio (Kip) of APB Xiengkhouang Branch (As of 30 September 2004)



28 Possible Cause of Too much Savings. In 2003, savings deposit rates were almost twice that of the current rates. (See Table 7). As for example, the ordinary savings accounts were given deposit interest rate of 12% while currently the rate is only 5%. Time deposit rates a year ago were likewise high. APB TDs of 3-, 6-, and 12-months were earning 15%, 18% and 20% p.a. interests, respectively, for their depositors in 2003 compared to only 8%, 9% and 10% p.a. interest earnings in 2004. Moreover, in previous periods APB had savings attractions including chances to win prizes in connection with savings deposits. Such high savings interest rates last year

and savings promotions could have caused the high liquidity situation of APB XK, aside from possible total economic growth in the province.

Table 7. Bank Deposit Rates (Percent) at 31 December 2003

Bank	Savings	3 Months	6 Months	12 Months
BCEL	12	15	18	20
LDB	10	13	15	18
APB	12	15	18	20
JDB	5	9	10	12
LVB	10	14	16	18
VCB	5	10	12	14
BBL	4	8	10	12
KTB	4	8	10	12
BAY	4	6	8	10
TMB	4	8	10	12
SCB	4	8	10	12
PBM	10	14	16	18

Source: BOL

Note: Banque pour le Commerce Extérieur Lao (BCEL), Lao Development Bank (LDB), Agricultural Promotion Bank (APB), Joint Development Bank (JDB), Lao-Viet Bank (LVB) and Vientiane Commercial Bank (VCB). Bangkok Bank Limited (BBL), Krung Thai Bank (KTB), Siam Commercial Bank (SCB), Bank of Ayudhya (BAY), Thai Military Bank (TMB) – and Public Bank of Malaysia (PBM).

B. Qualitative Data: APB Xiengkhouang Lending Scheme (including for IFAD Loans)

29 Lending Scheme. The lending scheme utilized for IFAD loans follows the group lending approach although loans are disbursed to individual clients under group guarantee. As per APB Credit Regulations, group lending approach is applied in cases where loans are not secured by physical collateral. It was found, however, that the group guarantee mechanism and the expected dynamics it is supposed to generate to ensure credit discipline and good repayment through joint liability did not work in practice. It was also evident that groups formed in the early phase of UNODC-IFAD lending were rather weak. This could have been brought about by rushed group formation, and the urgency to disburse the loans based on programmed targets and quotas. It could have been caused also by the lack of proper principles and techniques in effective group formation.

Group Formation

30 With the IFAD funds, group formation was supposed to be performed jointly by the LWU and APB field staff. Interviews with both agency staff indicated some degree of mis-coordination in the field regarding group formation. This can be partly explained by the mandate of each agency. While the APB is more concerned with ensuring repayment of loans on one hand, the LWU is more concerned with enjoining as many women as clients, on the other hand. The former (APB) decides on who the client will be on the basis of “economic and profitability reasons” while the

latter (LWU) decides on mainly “social and gender” reasons. Actually, there should be complementation of targeting (entrepreneurial poor and women as clients) as this strategy could achieve both economic and social objectives of all parties concerned--the bank, LWU and the client-households.

31 Part of the group formation procedure is the role of the village head in choosing members of the group. While this is the common practice and for protocol reasons, the village head could miss identifying and including in the group the more credit-worthy members of the village. Self-selection among group members remains as an effective tool in group formation if joint liability is to work. Usually group members would not include in their group someone who is going to be a potential problem member. Besides, they know each other better than anyone else including how they manage their microenterprise and market their products.

Loan Application

32 This step starts right after the group has been formed. A letter of interest by the group to borrow is written by the Group Leader and is certified by the Village Head. This letter of interest is sent to the APB Phonsavanh which studies it, then sends the staff to meet the potential clients in the village. In the village meeting, the APB staff presents the procedures, rules and regulations and criteria for eligibility to borrow. If after the presentation and the group members agree to borrow, APB will conduct a “socio-economic survey”. This survey is mainly intended to assess the financial status of the would-be loan applicants—an initial inquiry into their repayment capability. Simultaneously, the group will fill up the Loan Application Form which is then submitted to the bank through the APB staff.

Loan Appraisal

33 The APB through its Credit Committee assesses the loan application during its weekly meetings. This Committee consists of (i) Chief of Credit Division, (ii) Accountant, (iii) Internal Auditor, and (iv) Manager. They review the loan application and verify if it is consistent with results of socio-economic survey conducted earlier by the bank field staff. Adjustments on actual loan amount can also be made during this loan appraisal stage.

Loan Approval and Loan Contract Preparation

34 Once the Loan Application has been approved by the Committee, APB will inform the Group Leader who then informs the members about the bank’s action on their application. Sometimes, further questions about the application are asked or adjustments are required to be made. One adjustment is to reduce the loan amount. When no further changes are required, the APB prepares the Loan Contract with the applicants.

Signing the Loan Contract

35 Before signing the Loan Contract, the APB staff reads the content of the contract with the applicants. If group members all agree with the terms and conditions of the loan contract, both parties (bank and borrowers) sign it.

Loan Disbursement

36 Currently, every group member has to come to the APB Phonsavanh office to receive his/her loan funds. Previously, the practice was to release the loan funds to the Group Leader. However, this was stopped after some Group Leaders failed to hand over to the members their share of the loan.

Opening Accounts with the Bank

37 Upon loan disbursement, borrowers open two accounts with the APB. These are (i) Current Account, and (ii) Savings Account. The current account is meant for interest payments on the loan principal. This is a convenient way to make cash transfers as APB sends to headquarters all interest payments on IFAD loans. Opening the savings account is not compulsory though. It is a means to promote savings and mobilize excess cash from clients and the public.

Loan Use Monitoring

38 Fifteen days after disbursement of loans, the APB staff begins to monitor the use of the loan funds. Previously it was observed that most loans were not used on the basis of their intended purposes as per approved loan application. Recently, however, more than 95% of monitored loans have been in line with loan approved applications.

Repayment Scheme

39 The bank uses the conventional way of recovering loan payments. This simply means waiting for clients to come to the bank to make payments. Clients can make an agreement with the bank on the frequency of payments, although most interest payments are due every 3 months or on a quarterly basis. The repayment of the loan principal depends on the capacity of borrowers to repay but it needs to be paid on or before the due date. APB staff does remind the clients about repayment due dates. However, the current loan recovery scheme seems inadequate to improve the banks collection performance. Unlike the more innovative method applied by microfinance practitioners, there seems to be lack of non-conventional method to collect both interest and principal payments. Although notices and reminders are used, the bank branch is beset with large amounts of portfolio-at-risk. Bank management admits their real difficulty in improving their loan recovery rate. Perhaps, one solution is to try some innovative strategies or employ some microfinance best practice in effective loan repayment scheme such as requiring regular or periodic (weekly, fortnightly or monthly) amortized repayments in small amounts rather than full repayments of principal and interest at, say, end of harvest time (paddy rice). In most instances, farmers pay first all loans and financial obligations with friends, relatives, neighbors and the private moneylenders before settling obligations with the bank.

C. Other Findings

40 UNODC Loan Funds for Nonghet. In the course of the one-month study-review, the Team also encountered other issues that were raised during the KII and in the seminar conducted in Phonsavanh. It was learned from the verbal report

of the UNODC Field Coordinator that some UNODC loan funds which were disbursed to and later on repaid by the poor farmers in Nonghet district were transferred to the APB Head Office in Vientiane. As the funds were intended for Nonghet farmers doing alternative development projects in connection with reducing opium production, it was suggested that these funds be re-lent to the Nonghet farmers such as those producing asparagus in lieu of opium poppy. This concern will now be followed up by the APB Management with their head office and subsequently reported to the NPD of the UNODC-IFAD XK ADP as to the status of these UNODC funds.

41 Gender Segregated Data and Role of Women. While IFAD-UNOPS SM consistently recommended the targeting of women as loan and savings clients of the bank, the APB XK Branch has not yet come up with a record-keeping system that clearly identifies clients by gender. Thus, it cannot be clearly understood whether XK women borrowers repay better than men borrowers. The LWU provincial head also acknowledged that in the Lao context and due to the traditional culture, men still makes the decision with regard to making loans with the bank, although the loan becomes the obligation of the whole family and the wife could sign the loan application form with the husband. APB XK agreed to modify their loan applications to accommodate gender-related issues, and reported that they are now having more women as borrowers. The seminar in Vientiane at the UNDP office likewise reiterated the need to make microloans accessible to women especially those who are disadvantaged such as female-headed households due either to death of the husband, separation, divorce, or abandonment. The group membership criteria was also criticized in order to include lending to women regardless of marital status, and giving jailed and rehabilitated people a chance to make a decent living through micro loans. These reactions indicate the need for some revisions to the APB lending guidelines and policies in order to make them more poor and women-friendly. It is hoped that the APB policy-makers and top management attend to these comments and suggestions.

42 Positive Attributes of the Poor and Women. The meetings also brought up issues concerning the poor and women. Some of these include: (i) the poor are not lazy, (ii) the poor repay their loans better than the non-poor, (iii) women make use of their loans better than men and honor their loan obligations, (iv) women have strong capacity for group formation and cohesion, and (v) women undertake multiple roles in family management, rearing of children as well as in managing and running micro businesses.

VI. ISSUES/PROBLEMS ANALYSIS

43 Problems which were pinpointed in documents, reports and interviews⁵ have been classified in this study as follows:

- (i) General Bias and Prejudice:**
 - a. General perception that the poor are not hard working
 - b. Poor targeting—little emphasis given to women, the poor and poorest groups
- (ii) Gender-based:**
 - a. RFS component has not substantially contributed to uplifting the socio-economic status of women
 - b. Less number of loans to women
- (iii) Bank-based:**
 - a. Difficulty in loan repayment collection
 - b. “Group leader gets money from members but does not remit the payment to the bank”
 - c. “Group leader receives the loans for other group members but does not give to them”
 - d. Limited staff of APB
 - e. Lack of sub-service units in more remote areas
 - f. Concentration of marketing loans in Pek district
 - g. Limited skills and modern equipment
 - h. Too many long-term buffalo loans
 - i. Weak coordination between APB and LWU especially at the district level
 - j. High interest rate of IFAD loans compared to general APB loans
- (iv) LWU-based:**
 - a. Lack of microfinance training of LWU staff
 - b. Weak coordination between APB and LWU especially at the district level
- (v) Client-based:**
 - a. Member-borrowers moved to other places
 - b. Member-clients perceived the loans as grant money
- (vi) Project-based:**
 - a. Field reports come late due to remoteness
 - b. Weak coordination between APB and LWU especially at the district level
 - c. Language communication problem with remote upland villagers
 - d. Insufficient loan fund to reach all village poor

⁵ These reports include UNOPS Supervision Mission Report, March 2004 and Dr. Mana Southichack’s Report, 2000. Other problems were raised during key informant interviews with the APB, LWU and Project offices located in Phonsavanh, while field visits to Kham, Nonghet and Phaxai districts elicited various problems and difficulties encountered by village clients, village heads, and field staff of APB, LWU and the UNODC-IFAD Project.

44 The observations on long-term buffalo loans, lack of service units in more remote areas, concentration of marketing loans in more accessible Pek District, promotion of bank bonds as savings instruments, less number of loans to women borrowers, limited skills and modern equipment, and lack of coordination and cooperation between APB and LWU at the district level are symptomatic of more basic needs and problems as well strategies common to banks aiming at sustainability and profitability. Banks need to reduce costs of operations as much as possible so as to increase profits. As their main source of income is from interest payments, they too have to charge market rates of interest on their loans. The IFAD policy of targeting the poorest, the poor and the women among them, therefore, may not be in the best interest of a formal lending institution such as the APB. A conventional bank, by tradition, does not cater to the poor and women as bank clients. But it can if it likes to. Moreover, as the IFAD loan funds are loans by the Government of Lao PDR from IFAD (with interests and principal to be repaid at some future date), APB as the final lender of IFAD loans tries to behave rationally by lending to not-so-poor clients, disbursing more medium and long-term loans (to gain economies of scale in lending large volumes to few clients and reduce transaction costs) and to more accessible and less costly-to-travel villages, usually those that are near the branch office. The APB (provincial branch and head office) have to repay the IFAD loans and remit the interest payments to the Ministry of Finance which then pays back to IFAD. It appears therefore, that the policies of APB and of IFAD do not seem to match when it comes to targeting the poorest, the poor and women among them including those in upland areas.

45 Most of the problems listed down in the section above may not really be considered as problems because they are offshoots of bank policy. Banks are in the business of extending loans to the most profitable enterprises. They have to maximize their revenues, minimize costs and losses in order to gain profits and be sustainable. Lending to agriculture, more so to poor clients is quite risky from the bank's point of view. This, plus the traditional bias against poverty lending makes lending to the poor and to the women among them extremely unattractive to formal financial institutions. It would take a somewhat complete reversal of thinking or mindset before formal banks consider positively the idea that the poor are bankable, and that it is possible to lend to them without collateral, and that they will pay back their loans.

46 Otherwise, the alternatives could be to: (i) formulate a set of alternative banking policies, procedures and practices for this group of clientele and get these implemented by formal financial institutions (through a microfinance window or unit) which believe in microfinance as an effective poverty reduction instrument, (ii) set up an alternative banking institution mainly for the poor and women and other disadvantaged groups with their existing microenterprises, (iii) promote private initiatives towards the creation of microfinance institutions that would cater to the microfinancial needs of low-income groups and of women microentrepreneurs, and (iv) strengthen the capacity of existing organizations or agencies such as the Departments of Finance in Oudomxay and Sayaboury which have pioneered in microfinance operations since 1998. These could be expanded and replicated in other provinces especially in poorer districts in order to reduce poverty substantially before year 2015.

47 More basic problems such as gender bias against lending to women and limited income-generating activities solely performed by women are initial hurdles that have to be overcome from both social and economic points of view. The LWU could specialize in assisting the villages as well as the APB in terms of community organizing and group formation, while the APB could specialize in the provision of financial products and services that will assist the poor clients in the production of marketable goods (farm products, handicrafts, etc.) and services (petty trading, etc.) that generate surplus income that enable them to repay their loans and thereby borrow again to their benefit.

48 “Forced” savings through bank bonds indicates a need for innovative savings product creation and promotion. Mobilizing savings at the time of loan disbursement seems rather untimely and non-strategic. The habit of saving small amounts of cash can be developed and can start even before loans are disbursed. But this requires some microfinance best practice techniques. Effective savings mobilization among poor or low-income people can start much earlier while at the social preparation stage (in the process of group formation, group training and values-reorientation). This can be incorporated in a new APB Manual of Operations for Microfinance wherein an effective group formation is a required strategy to before any lending has to occur.

49 Poor Group Formation: Source of Many Problems. It was evident in most of the discussions with key informants that many of the more salient problems like poor repayment, and other institutional-based (APB and LWU) and client-based problems could be attributed to weak and ineffective groups. Such groups could have come about due to erratic group formation, especially when loans have to be disbursed using the group methodology. The problem gets worse when loan funds need to be disbursed within a given period on a quota system. In these situations, group formation tends to be rushed. This can have long-term detrimental effects on the program. Rushed group formation can miss the basic principles of effective group formation which are hinged on (i) self-selection of group members by the villagers themselves, (ii) careful vetting of potential members, (iii) choosing members with similar socio-economic standing in the village, (iv) grouping with members of same gender, and (v) not having members closely related by blood, up to the third degree of consanguinity, to be in the same group. Of course, in the Lao context, some room for adjustment can be made. However, the role of the village chief in vetting and in providing moral pressure is likewise important.

50 Coordination between APB and LWU. The problem regarding lack of coordination between the LWU and APB staff especially at the district level was expressed and admitted by both institutions in the province. It appears that part of the ineffective group formation problem arose because of this lack of coordination between the so-called “foot soldiers” of LWU and APB with regard to community mobilizing and organizing and eventually forming joint liability groups required to avail APB lending. Proper coordination between APB and LWU can help screen out potential bad eggs in the group. LWU could assist in vetting women borrowers and assist the APB staff in evaluating enterprise productivity and character of the potential women borrowers. The APB field staff could likewise suggest possible profitable income-generating activities that are in line with APB financing priorities. These information the LWU may have to disseminate to its all women membership.

51 While limited skills, extending marketing loans close to the branch office, limited investment in equipment, limited coordination, and limited presence in remote areas could be cost-reduction strategies in order to maximize revenues, these may, in effect, jeopardize the long-term sustainability of the bank branch. APB needs to invest in remote areas as agriculture remains to be the backbone of the economy. The microfinance market is huge and to be a first mover in remote rural areas by investing there will also make it a market leader in providing rural and micro financial services in those areas.

52 The problems, issues, difficulties, weaknesses and related observations listed above further highlight the need to understand clearly the principles of poverty lending and savings mobilization as well as microfinance best practices in relation to the overall rural financial system. The IFAD policies and requirements are in line with poverty targeted lending, particularly in remote agricultural areas. The APB can be the most appropriate financial institution to engage in poverty reduction if (i) it seriously adheres to and implements even on a trial or piloting basis, a well-formulated and planned microfinance project, and later incorporating the experience, if successful, into its overall machinery as a unit or a window, or (ii) it can modify some of its policies and guidelines to suit microfinance principles, procedures and practices, towards being more poor and women-friendly in the provision of its services and products.

VII. SOLUTIONS ANALYSIS

Group Formation-based solutions

53 In addition to the short discussion in para. 47 above, some of the additional group formation-based solutions may include: (i) adequate social preparation of the poor and potential women borrowers, which may include adult non-formal education or training in numeracy and literacy, (ii) effective group formation--not rushed, no close relatives, gender sensitive, socio-economic homogeneity, (iii) effective training on group member responsibilities and lending-saving discipline, and (iv) careful choice of members through vetting.

Enterprise-based solutions

54 Successful rural and micro finance experience combines lending to clients who have combination of short and long-gestating enterprises. Most non-farming activities are of short duration and generate cash more frequently such as petty trading, while farming enterprises are usually generate cash after a long time. Non-farm goods and services would enable the borrower to have cash at regular short intervals. Part of this cash earnings can be used to repay loans from the bank. Moreover, potential borrowers should always have existing microenterprises and market to absorb their products or utilize their services.

Bank-and Policy-based solutions

55 A number of bank and policy-based solutions can be forwarded. These may include (i) streamlining bank procedures, (ii) clarifying bank policies, vis-à-vis IFAD policies, and (iii) having pro-active and innovative banking culture with aggressive and dedicated field staff. Paragraphs 44 and 45 have discussed partially some of the

possible solutions to bank-related problems, in particular, as the APB embarks on poverty lending and observance of microfinance best practices. The bank may also develop the following: (i) aggressive collection scheme, (ii) innovative savings products, (iii) consistent terms and conditions, (iv) interest rate that covers costs, and (v) effective staff training courses. Some of the microfinance best practices the bank can adopt to improve its repayment performance may include the following: (i) proper group formation and training, (ii) provision of small loan size for first time borrowers, (iii) small regular repayments of loan principal, (iv) short-term lending for poor clients, and (v) close monitoring and supervision.

Client-based solutions

56 Client-based solutions to the problems elicited from interviews and documentary research would zero in on the creation of credit discipline among the borrowers through a thorough value-reorientation beginning at group formation stage. Such values to be inculcated among the low-income clients may include personal discipline as it relates to repayment, hard work and creditworthiness. Among clients with limited production and income-generating skills, training may be necessary before loans are extended to them.

Institution-based solutions

57 Based on field observation and independent interviews, bank staff are limited in doing more regular field work and follow up due to lack of sufficient transport facilities to reach more remote villages. Thus, it is suggested that if possible, some of bank profits be allocated to the provision of attractive benefits and provisions to field staff who have direct contact with low-income clients. Investment in human resource is critical in poverty-reduction activities as these entail substantial exposure in the field in order to coordinate activities with village officials, other agencies operating in the communities and in maintaining close rapport and solidarity with the clients. LWU and APB at the central, provincial and district levels need to forge an agreement towards closer coordination, communication and complementation of activities (especially at the district and village levels) to ensure that overlaps and misunderstanding are prevented from happening. The main goal is to deliver microfinancial services to the poor and women in a coherent and synchronized manner.

VIII. RECOMMENDATIONS/SUGGESTIONS

58 Given the nature of this short-term consultancy, the following recommendations are being forwarded:

- Establish a Microfinance window of APB
- Pilot MF Best practices in a poor district
- Increase social and physical infrastructure in remote areas
- Strengthen group formation mechanism
- Support APB restructuring plan, whenever necessary
- Transfer back to APB Xieng Khouang Branch the IFAD II and UNODC loan funds that were remitted to APB Head Office in Vientiane, for the re-use of low-income farmers in Xieng Khouang province especially those in Nonghet

district who have shifted from opium production to alternative livelihood activities.⁶

The above listed suggestions are geared towards improving the capability of APB to service the rural and micro finance needs of low-income groups of people in Xiengkhouang province.

59 Based on the outcome of the quantitative analysis of data provided by APB XK, it is further recommended that for APB to improve its repayment performance in the future, it has to (i) provide more loans which are short-term, (ii) provide more loans to clients who reside in villages and districts away from Pek or the commercial area of Xiengkhouang. The main reason for recommending these strategies stems from the fact that short-term loans have lesser delinquencies and districts which are away from the APB Branch office in Phonsavanh/Pek district have better repayment rates. By doing so, APB will also be in a position to provide the low-income and poorer sectors who are mostly found in more remote areas, and whose loan requirements are usually short-term and of smaller sizes compared to the kind of loans well-off borrowers would demand.

⁶ It is further suggested by the Team that a formal request and follow up be made by UNODC-IFAD Project with APB Head Office in Vientiane to resolve this issue, copy furnished to the APB XK management.

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LAO PEOPLE'S DEMOCRATIC REPUBLIC
Peace Independence Democracy Unity Prosperity

Policy Statement for the Development
of
Sustainable Rural and Micro Finance Sector

Drafted by:

**Rural and Micro Finance Committee (RMFC),
Bank of the Lao PDR
August 2003**

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SECTION I: INTRODUCTION

1. Overview

Lao PDR is one of the least developed countries. 80% of Lao people live in rural areas. The number of poor households are estimated to total 252,449 households¹, which accounts for 28.08% of the total number of households in the country. However, it is estimated that only 7% of the total number of poor households have access to rural and micro finance services. Access to basic financial services, such as a safe place to deposit savings and to borrow money at affordable rates, is an important tool for people to be able to increase their income, build their businesses, and manage shock throughout their life cycle. Therefore, the Government is intended to promote the development of the rural and micro finance sector (RMF) to increase outreach so that people who do not have access to the banking system's services can satisfy their financial needs. Substantial and sustainable development of the sector can significantly contribute to the implementation of the Government's policy for poverty reduction, as codified in the Millennium Development Goals and the National Poverty Eradication Paper.

The Government's vision for the financial sector reflects these poverty reduction goals, and the objective of meeting international standards. The financial sector will be supportive of broad-based sustainable economic growth and reduction of poverty. The financial sector will help enable the Government to achieve its goal of graduating from the least developed country status by 2020. The financial system will have the depth needed for economic growth and development and will promote macroeconomic stability. There will be strong bank and non-bank institutions that efficiently allocate the country's resources to the most productive investments and income generating activities of people nationwide. The sector will be diversified and will provide wide access to financial services and extensive market reach.

2. Definitions of key words

Some key words to be referred in this document have following definitions:

2.1 Micro Finance: means the provision of a broad range of financial services, such as cash based credit, deposits, insurance, etc, **to the poor, low-income households, and their micro-enterprises.**

2.2 Rural Finance: means the provision of a broad range of financial services, such as cash based credit, deposits, insurance, etc, **to people and enterprises located in rural areas.**

¹ From the National Meeting for Poverty Reduction I, 2003

SECTION II: CURRENT SITUATION OF RURAL AND MICRO FINANCE SECTOR IN THE LAO PDR

Rural and Micro Finance Sector (RMF) in the Lao PDR is still in its infant stage, which could be contributed by supply, demand, and policy constraints. On the supply side, while there are several RMF initiatives in rural and urban areas, operated by many domestic and international organizations, such programs have only limited outreach due to inadequate funds and limited variety of services, which do not fit clients' needs. On the demand side, existing and potential RMF clients in general still lack awareness and understanding of how they can use financial services from RMF sector to improve their living conditions. Additionally, existing policy and regulatory framework do not provide an enabling environment for a sustainable development of the sector. Aware of these constraints, during 2002-2003, Bank of the Lao PDR (BOL) had conducted an extensive data collection and consultation with the key parties nation-wide, including domestic and international agencies, involved with RMF sector, to assess the current situation of the RMF sector. Major findings are as follows:

1. Strengths

- RMF services are able to mobilize local savings and enhance effective use of fund that can contribute to living condition improvement and poverty reduction among Lao people.
- Most of RMF methodologies are suitable to the needs of the Lao people.
- Some pilot Lao Microfinance initiatives are successful and can become sustainable.
- Potential demand for such services is very high.

2. Constraints and Weaknesses

- The supply cannot fully reach the demand².
- Some policy makers, local authorities and donors still lack a solid understanding of sustainable market-oriented RMF.
- The emerging microfinance institutions are crowded out by the existing subsidized credits programs.
- There is a lack of exit options for sustainable projects, as they cannot transform themselves into institutions.
- The existing regulation restricts the development of the microfinance sector.
- Management capacity of micro finance initiatives is limited.
- A majority of RMF initiatives are not sustainable.
- Lack of understanding that RMF is not suitable for poorest, who lives in very remote areas. These groups need other kind of assistance.

3. Some causes for under-development of the sector

- The concept of RMF is not fully disseminated.
- Low population density and difficult market access.
- Policy, legal and regulatory frameworks are not conducive for MFIs yet.
- Subsidized credit affects the rapid development of MFIs.
- Coordination among different key stakeholders is inadequate.

² (Approximately 7% of total number of poor households have access to RMF services excluding money lenders)

4. Opportunities

- Potential demand for such services is very high.
- Some donors and private businesses, both local and foreign, would invest in RMF sector if environment were conducive.
- Conducive policies for the private sector would increase emergence and expansion of MFIs.
- Development of infrastructure and education increases access to RMF.
- A developed rural and microfinance sector could foster savings mobilization amongst Lao people.
- GOL is committed to reform APB into a sustainable market-oriented institution.
- GOL is committed to create a supportive environment for the development of a variety of microfinance institutions.

5. Threats

- High inflation could de-stabilize the RMF sector.
- Lack of a certain and simple process for registration and restrictions on mode of operation could discourage the emergence of MFIs and could lead to increasing power of moneylenders.
- Pressure to continue subsidized lending could undermine RMF by crowding out MFIs and by requiring MFIs to charge un-sustainable interest rates.
- Lack of an adequate awareness and understanding of an importance of the RMF sector could delay the implementation of this policy and action plan.

SECTION III: POLICY AND VISION FOR DEVELOPMENT OF RURAL AND MICRO FINANCE SECTOR

This policy is aimed to create an enabling environment for a sustainable development of the rural and micro finance sector in the Lao PDR. As the RMF sector cannot be viewed in isolation of the whole financial system, the reform program should enable the RMF sector to be integrated into the overall financial system. Specific policy and vision for the sector have been identified. A time-bound action plan to reform the sector together with roles and responsibilities of parties involved in RMF sector are determined. This can serve as key milestone to monitor progress of the reform program. By taking into account the findings in SECTION II regarding the current situation of rural and micro finance sector as well as the socio-economic situation as a whole, the following program of policy and vision reform for the RMF is to be implemented.

1. General statement

Sustainable rural and micro finance can be effective tools for poverty reduction, which can help Lao PDR to emerge from LDC status by 2020. The GOL reform program in rural and micro finance will enable the sector to expand significantly, with diversity, security and future sustainability. The RMF reform program is a major contribution into the implementation of the National Socio-Economic Development Plan.

2. General vision for development of Rural and Micro Finance Sector

Vision for development of the rural and micro finance sector will focus on the four areas of activities as follows:

2.1 The RMF sector will expand significantly:

RMF will significantly expand over time to increase outreach to the greater number of poor in Lao PDR. Currently, the sector reaches only a small percentage of the Lao population.

2.2 The sector will include a diversity of independent MFIs:

The sector will comprise several new MFIs with a diversity of legal ownership, including private and/or public ownership. It will also develop a variety of methodologies, to reflect the diversity of the Lao people and situation. The MFIs will be managed and governed autonomously. The national laws and legal instruments will support the development of the sector.

2.3 The sector will gradually become sustainable:

By 2005, most of the people involved in RMF will share common understanding of RMF best practice and sustainability. RMF initiatives will have a plan to become sustainable. Interest rate will be set by MFIs' management based on full cost recovery, profitability and market demand. The management of MFIs will be fully accountable and skilled.

2.4 The environment will ensure security for depositors:

An appropriate legal and regulatory framework will be designed and implemented. Supervision of MFIs, especially large deposit taking MFIs, will be strengthened in order to ensure depositors' protection.

3. Clarification on the four areas of the vision

3.1 Expansion

According to the estimation, while 28.08% of total number of households is poor, but only less than 7% of total number of those poor households have access to rural and microfinance services. The existing number of rural and micro finance institutions is not sufficient and they have not yet been properly promoted to be able to expand and meet the current demand. To ensure access to financial services by the poor and outreach, the sector will need to expand significantly but not recklessly. This calls for the need of enabling environment to allow the emergence of new RMF institutions and the expansion by existing MFIs.

This expansion will take time and require experimenting of different types of methodologies, based on the diversity of the Lao population. In simple words, the RMF services should be reached by the larger number of people. However, the RMF sector should not be expected to reach the most remote areas of the country, or serve the poorest population who live in the subsistence economy without access to markets for their products. This segment of the population needs other types of assistance such as the donation or aids from domestic and/or foreign charities, public and/or private and/or international funds etc. in order to help improve their economic and living conditions before they can have access to services provided by the formal financial sector.

3.2 Diversity

Currently, most of the RMF programs have been operated under the public authorities. The reform program will enable different models of MFIs to emerge, such as private companies, credit unions, cooperatives, private and/or public specialized banks. It will be particularly important to encourage private initiatives, considering the limited resources of the public sector. New initiatives will require autonomy in their management, hiring procedures, interest rates, access to capital, and choice of products, clientele and geographical areas etc.

3.3 Sustainability:

Sustainability is essential to:

- Ensure longevity of sector;
- Ensure integrity of the financial system and ensure an integration of RMF sector into the financial system;
- Ensure large outreach;
- Ensure independence from national budget;
- Enable RMF initiatives to stand on their own feet and live long;
- Avoid relying on subsidies from the Government or donors for many years;
- Allow people to have many loan cycles, which is very important for the poor to have enough time to step out of poverty.

Some conditions needed for achieving sustainability include:

- Rural and microfinance projects and institutions need to have legal status.
- MFIs need to have management with appropriate skills, knowledge, and ethical standard (financial discipline). In addition, the management of RMF projects and institutions needs to have a clear vision on sustainability since the very beginning.
- MFIs need to be autonomous and accountable by being allowed to make management decisions regarding products and services to offer, clients and areas to serve, staff to hire, and price to charge.
- MFIs need to operate in a level playing field without having to compete unfairly with subsidized credit from institutions and projects.

- RMF institutions need to have access to national and international public and private investors to expand.

3.4 Security:

Clients who deposit their savings with an MFI need to have security. Therefore, in order to protect depositors, MFIs, which mobilize voluntary saving from general public and whose assets reach a certain size should be required to comply with prudential regulations. Supervisory agent and prudential regulations for large MFIs will be developed and implemented. Capacity of supervisory authority will be strengthened to ensure effective implementation. However, the implementation of prudential regulations should not constrain the emergence of MFIs.

SECTION IV: ACTION PLAN FOR IMPLEMENTATION OF THE REFORM PROGRAM FOR RMF SECTOR IN THE LAO PDR

The action plan to implement the RMF reform consist of three main areas as follows:

1. Build common understanding and consensus on the government's policy and vision in RMF reform. To ensure successful implementation of the government policy, key stakeholders in the sector (policy makers, local authorities, donors, and practitioners) need to be aware of the policy, be consulted on and understand its content.
2. Strengthen existing RMF initiatives and institutions to ensure that the industry will become sustainable and can contribute to poverty reduction. Currently most existing initiatives in the sector do not appear sustainable.
3. Develop enabling legal and policy environment for the establishment and operation of different types of MFIs. Currently, the majority of RMF initiatives are operated by the public agents (APB, LWU and local authorities). This can constrain the industry growth and outreach since the public sector has limited access to human and financial resources. As private MFIs have better access to financial and human capital and can contribute significantly to the growth of the industry, MFIs with private ownership should be allowed to operate.

NOTE: See appendix for the details of the action plan with proposed responsible authorities and expected time frame for each action.

APPENDIX

Table 1: Build common understanding and consensus on the government's vision and policy in RMF reform:

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Disseminate the policy statement, vision and action plan to high level authorities and other key stakeholders (donors, and practitioners) at central level after policy documents are endorsed by PMO.	BOL		■	■	■	■	■	■	■	■	■	■
Organize provincial workshops to sensitize officials at different local-levels on the Policy, Vision and Action Plan for RMF sector.	RMFC				■	■	■							
The mandate of the RMFC, with appropriate budget, will be revised and expanded to be responsible for the oversight and co-ordination of the implementation of the Action Plan.	BOL					■								
In addition to the Policy Statement, Vision and Action Plan, develop strategy and legal framework to support the development of RMF sector	BOL, RMFC ³	■	■	■	■	■								
Organize a high level workshop annually to monitor progress in the implementation of the reform program	BOL, RMFC					■							■	■

³ with FIRST/ADB's TA

Table 2: Strengthen existing RMF initiatives and institutions to ensure that the industry will become more sustainable:

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Reform APB into a market oriented institution and remove interest rate subsidies	MOF, BOL, APB ⁴											
Develop appropriate prudential regulations to supervise APB and large deposit-taking MFIs; the prudential regulations can be implemented in stages, depending on the depth of the industry and size of MFIs.	BOL, RMFC ⁵													
Strengthening the supervisory capacity to prudentially supervise APBs or large deposit taking MFIs.	BOL ⁶													
Disseminate and build awareness of rural and microfinance best practice by organizing nation-wide workshops and seminars for all relevant provincial officials and practitioners. Capacity building or training program on best practices for practitioners and officials.	RMFC ⁷													
Quarterly consultations take place between related government authorities and RMFIs to review progress with the implementation of the Action Plan, constraints and issues encountered in resolution and mutually agreed action for their remedy.	RMFC ⁸													
Encourage the RMF service providers to conduct market survey and organize training on effective use of fund for their clients, this will help to ensure the using of fund in line with the set purposes and to ensure the collection of loan granted.	RMFC ⁹													
Conduct the studies and disseminate their results on different micro finance methodologies and best practices for all related parties (both supply and demand sides) to enhance their understanding and to facilitate their decision making on the options that are better suit to their activity and need.	RMFC, NERI ¹⁰													
Make assessment of large initiatives for their potential as well as the pitfalls that need to be adjusted to ensure their sound operation/being able to use as model for others.	BOL, RMFC, NERI ¹¹													
Coordinate rural and micro finance reform program with SCB restructuring program.	MOF, BOL, RMFC, SCBs													

⁴ with ADB's TA

⁵ with FIRST/ADB's TA

⁶ source of funding is to be determined

⁷ with ADB's TA and other source of funding (CGAP or others)

⁸ with FIRST/ADB's TA

⁹ source of funding is to be determined

¹⁰ with support from Concern Worldwide

¹¹ source of funding is to be determined

Table 3: Prepare an enabling legal and policy environment for the emergence of private MFIs.

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Review existing Lao policy and legal issues and cross-country experiences and best practice to develop appropriate legal instruments (decree, guidelines, regulation, and registration) for Lao RMF sector. The legal framework should allow for autonomy in management by MFIs, the diversity of MFIs both in forms and ownership structures, the transformation of MFI initiatives into institutions. The development of legal framework should be on a consultative approach.	BOL, RMFC ¹²											
Disseminate the legal documents to policy makers, local authorities, donors and practitioners as references for their roles and responsibilities.	BOL, RMFC ¹³													
Promote the effective implementation of such legal instruments, especially on the issue of autonomous management and operation of the RMF institutions, through the close and regular coordinating among all relevant authorities.	BOL, RMFC ¹⁴													

NOTE: Abbreviation

- ADB** : Asian Development Bank
- BOL** : Bank of the Lao PDR
- GOL** : Government of the Lao PDR
- MOF** : Ministry of Finance
- MOJ** : Ministry of Justice
- RMFC** : Rural and Micro Finance Committee
- WB** : World Bank
- RMFI** : Rural and Micro Finance Institution

¹² with FIRST/ADB's TA

¹³ with FIRST/ADB's TA

¹⁴ with FIRST/ADB's TA

Appendix 2. Rural Financial Services (RFS) Consultancy Work Plan

Date	Activities
21/10/2004	Meeting with UNODC (Mr. Leik Boonwat) and UNDP (Ms. Khamsene Phengphong) re: Briefing on IFAD II project and APB loan scheme
22/10/2004	RFS Consultants travel to Xiengkhouang
25/10/2004	Meeting with Dr. Bounpone Sirivong, NPD, IFAD II and Mr. Phonexay, APB Branch Manager re: Courtesy Call; Project overview and secure reports, documents relevant to the assignment
25/10/2004	Meeting with APB Branch Manager and Deputy Branch Manager re: overview of APB operations on IFAD loan, etc.
26/10/2004	Meeting with Lao Women's Union (LWU) re: Group formation and training, issues/problems, etc.
27/10/2004	Meeting with Deputy Branch Manager (APB) re: Lending systems and procedures, savings mobilization strategy
28/10/2004	Office work on documents translations, Team discussions, clarifications with Deputy Branch Manager
29/10/2004	Office work at APB
30/10/2004	Study the documents from IFAD II Project and APB
31/10/2004 (Sunday)	Day-off (Report writing)
01/11/2004	Work at APB; Prepare for field visits; Analyze reports and lending data
02-05/11/2004	Field Work in Nonghet, Phaxai and Kham districts
06/11/2004	Office Work at APB; Progress reporting to NPD, UNODC, UNDP
07/11/2004	Day-off (Report writing)
8-11/11/2004	Verification meetings with APB, LWU, IFAD II Project; Report writing
12/11/2004	Draft Report Presentation with NPD, APB, LWU
13/11/2004	Travel to Vientiane
14/11/2004	Day-off (Report writing)
15-16/2004	Report writing
17/11/2004	Draft Report; Prepare for Central Level Seminar on Findings and Recommendations
18/11/2004	Presentation of Draft Report in a Seminar in Vientiane; Revise Draft Report based on seminar comments
19/11/2004	Exit meeting with UNODC/UNDP; Submit Final Report

Appendix 3. APB Credit and Savings Group Regulation

Laos people's Democratic Republic
Peace-Independence-Democracy-Unity-Prosperity

Regulation of Credit (to group without security)

The Agricultural Promotion Bank (hereinafter called "APB" is state-owned commercial bank, established according to Prime Ministerial Decree No. 92/PM dated 19 June 1993. It is in the banking sector and is a mainly non-profit operation that provide service (profitable) and credit facilities to individual farmers or group of individual who undertake commercial production in the agricultural, forestry and handicraft sector.

APB Headquarters is located in Vientiane municipality. The bank has branches throughout the country as authorized by the national bank of Lao PDR (Central Bank).

APB has determined regulations on loans to established groups without property and individuals or enterprises that have property to guarantee the loans.

I. Group Credit of APB

The group credit of APB is an organization that aids the situation of farmers in need of capital and want to borrow for their businesses. They can do so as a joint group under the following conditions:

1. Farmers who do not have security are put in a list by the head of the village. They thus establish the formal group at this place.
2. The village party leader or village head is responsible in selecting suitable candidate farmers under the condition set down by APB.
3. The Group of APB is composed of: Group Leader, Deputy Group Leader, and a number of 5-20 people. The members are all nominated by the village head.

II. Behavior and Conditions (Eligibility of Farmers)

In the case of APB Lending fund to farmers without property: APB assigns the responsibilities to the head of the village or the secretary of the party in the village to select farmers to join the group that will borrow money from the APB. APB likes this because the head of the village knows very well about the history of residents and who should thus be considered appropriate. Were the APB to be charged with this selection responsibility, there would be a higher probability of error in the process.

Conditions for eligibility of farmer

- Lao nationality
- Age 20-55 years and married
- Farmer in area for many years or (at least one year)
- Have an official household register
- In need of financial support (lack funds)
- Hard working people and thrifty with their money
- Are faithful person

- Have not been sentenced to jail by court
- Have a good health
- Have no debts (not bankrupt)

III. Duties and Responsibilities of Village Head

Selecting farmers to be members of an APB Group is very important because Group members do not have security (physical collateral) to guarantee their loans.

Selection of representative must be just.

1. Must select a faithful person.
2. No relative and intimate friend.
3. Have responsibility and guarantee to APB that farmers were selected in good faith.
4. Work with credit staff to determine the loan which is appropriate for each farmer and this is sent to the board for approval.
5. Have a responsibility to supervise farmers and to advise them
6. Have responsibility of auditing production activities for their success.
7. Have responsibility to co-operate in work load of field officers.
8. Have a responsibility to report farmer's problems to APB , such as: floods, drought, damage due to insects.
9. Advise and facilitate and prepare repayments and on time.
10. Advise the leader (Group Leader) and the members of the Group to wrap up meeting about credit design activities, develop concise summaries for the conciliation of debt and other problems.
11. Responsible to consider and solve problems concerning the work load of field officers, and to develop repayment schedules.
12. Responsible to use appropriate discipline towards members who fail to make repayments, are obstinate, or perhaps move to other places unannounced.

IV. The Guaranties in Group

Credit regulation for lending in non-secured situations with established Group involved choosing farmers in the same village who know each other and apply together for loans from the Bank.

1. The head of village must confirm to APB. The Group that they set up must function well and they can solve their problems internally.
2. Farmers become member of APB's Credit Group that borrows money to carry out agriculture promotion.
3. They have to share their responsibilities together. If any one client can not pay back the loan to APB, together members have the responsibility of paying back the loan to the APB.
4. These responsibilities together will be cancelled if the members have finished repayment of principal and interest.
5. If one of the clients can not pay back the loan to APB, the members still have to share their responsibilities together as a unit.
6. If one of the clients in the group dies, the husband or wife or son or daughter (the person who receives the inheritance or estate) assumes their share of responsibility.

V. Responsibilities in Using Funds for Resource Projects

APB Borrows funds from the Bank of Lao PDR (BOL) or Government for lending to priority projects such as:

- Food Production Projects
- Purchasing Production
- Rural Development Projects

A) The responsibility of Senior Province and Village

1. Senior management of province selects and determines the focus area, the credit investment and their purpose.
2. Set up the committee that involves sections within the province.
3. The head of the village has the responsibility of selecting poor farmers who lack collateral security but possess good character to abide by the conditions of group regulations.

B) The responsibility of the Technical Section

Technicians in Agriculture such as Cultivation, Livestock, Irrigation, and Poultry have certain responsibilities such as:

1. Technicians should calculate data for creating investment projects along with purpose of funds.
2. Set-up the short training for the members who receive loans from the APB to improve their knowledge and help them know how to use the technical knowledge in production of:
 - Livestock (poultry, pigs)
 - Cultivation (dry season, rainy season, beans, coffee and others)
 - Irrigation (how to take care of the machine by electricity and by oil, digging channels)
3. Survey and assess using technology for the area of project.
4. Co-operation involving other sections of project activity.

C) Agricultural Promotion Bank

1. Set up the credit plan for farming families who were selected and confirmed by the village head.
2. Determine the purpose of loan consistent with the fund approved by the (BOL) such as crop (dry season and rainy season).
 - APB provides loans to farmers to buy the element of production such as rice seeds, fertilizer, plantation, insecticides, oil, labor, etc.
 - Poultry. (Purpose of lending are: new breed, fodder, germicide).
 - Livestock loan purpose: to buy the bull, cow
3. Join with the village head to determine the appropriate borrowers and then summarize the credit plan to the headquarters for approval.
4. Lending should be for an exact purpose and before the season starts.
5. Credit supervision and the appraisal review.
6. Co-operate with the committee and the heads of villages to summarize the project activities.

VI. The Resource of substandard.

Members of the group can not reimburse APB on time. There are two reasons including a direct reason and an indirect reason of the member.

1. Direct reason:
 - Death
 - Stops producing
 - Moved to another place
 - Have any overdue debt
 - Is not a faithful person, misrepresent himself
 - Is prosecuted or penalized

2. Indirect reason:
 - Flood, drought (lack of rain)
 - Production is damaged by insects
 - Diseases
 - Can not sell the products
 - Low price
 - Does not have market for products

VII. Substandard protection

The first job to protect the loan in the beginning:

- Selecting a suitable farmer and confirming to the regulation and condition before giving the loans.
- The loan should be appropriate for the individual need, not beyond their capacities to repay and to fix a date for repayment.
- Lending is correct in keeping with the purpose.
- Conducting a through credit assessment of the borrower.
- Follow-up the member's production with visit to field.

VIII. Renewal of a Contract or non-Renewal of a Contract

1. Renew a contract.

Renewal of a contract to the member's group, the head of group, the head of the village and field credit staff mutually agree upon. At the same time, the field staff sends the list to the board of directors of the branch.

The reason for renewing a contract may be as follows:

- A member in the family suffers from harm or dies
- Production is damaged by drought, flood, lack of rain
- The produce is damaged by insects and crop can not be harvested
- Can not sell the produce.

The renewed contract should reflect the appropriate and current real situation. The period of time to renew is a maximum of 12 months (1 year).

2. Not renew a contract

APB will not renew a contract for members of a group if:

- Loan is not used for the stated purpose (fungibility of money)
- Borrower does not do the work specified
- Not faithful to the terms of the credit facility
- As mentioned above, APB must withdraw a Loan from the members and refer to the of head of village good and all members in the group when it is determined that:
- The members in Group repayment the loan to the APB for him/her
- The head of village sells his/her properties
- up members agree to sell his/her properties

If one member of the Group can not pay back the loan, APB will not lend to the Group until such time that the original credit is fully repaid.

Vientiane 22 April 1999

Appendix 5.1 List of the Persons Met

No	Name	Position	Organization	Date
1.	Mr. Leik Bounvath	Alternative Development Advisor	UNODC	22/10/2004
2.	Ms. Khamzene Phengphong	Programme Associate	Livelihood & Environment Unit, UNDP	22/10/2004
3.	Dr. Bounpone Sirivong	National Project Director	Xiengkouang Agricultural Development Project Phase II	25/10/2004
4.	Mr. Phanthaboun Sayaphet	Deputy Managing Director	Agricultural Promotion Bank	1/11/2004
5.	Mr. Phonxayha Yuoayia	Branch Manger	APB, Xiengkouang Province	25/10/2004
6.	Mr. Oudonetheun Rasaphon	Deputy Branch Manger	APB, Xiengkouang Province	25/10/2004
7.	Mrs. Khampoui Ngoy Saikham	Administrator	LWU, Xiengkouang Province	26/10/2004
8.	Ms. Bounpheng Nonthavong	Coordinator	LWU, Xiengkouang Province	26/10/2004
9.	Mr. Khamphat Keovilay	Credit Officer	APB, Phaxay district	2/11/2004
10	Mr. Bounthang Phothixay	Credit Officer	APB, Phaxay district	2/11/2004
11	Mr. Ounsouvanh	Credit Officer	APB, Kham district Sub-Service Unit	3/11/2004
12	Mr. Xaoya	Credit Officer	APB, Kham district Sub-Service Unit	3/11/2004
13	Mr. Khamla	Credit Officer	APB, Kham district Sub-Service Unit	4/11/2004
14	Mr. Keovithoun Sengsavang	Sub-Service Manager	APB, Kham district Sub-Service Unit	4/11/2004
15	Mr. Bounlieng	Village chief	Ban Thang	2/11/2004
16	Mr. Sisouphan	Village chief	Ban Thang	2/11/2004

No	Name	Position	Organization	Date
17	Ms. Khamheuong	Client	Ban Thanxay	3/11/2004
18	Ms. Bouahong	Client	Ban Thanxay	3/11/2004
19	Ms. Kheurn	Client	Ban Nathoum	4/11/2004
20	Mr. Khampheng	Client	Ban Say	4/11/2004
21	Mr. Phonxay Bounsomphong	Chief of Credit division	APB, Xiengkhouang branch	12/11/2004
22	Mr. Somphan Youanya	Internal Auditor	APB, Xiengkhouang branch	12/11/2004
23	Mr. Phoutsavath Sounthala	Assistant to NPD	PFU Vientiane, UNODC	12/11/2004

**Appendix 5.2. List of Participants (Initial Finding Meeting at Xienkhouang Province)
12 November 2004**

No	Name	Position	Organization
1.	Mr. Phonxayha Yuoyayia	Branch Manger	APB, Xiengkouang Province
2.	Mr. Oudonetheun Rasaphon	Deputy Branch Manger	APB, Xiengkouang Province
3.	Mr. Phonxay	Chief of Credit Unit	APB, Xiengkouang Province
4.	Mrs. Outhen Malisonsay	Vice President	LWU, Xiengkouang Province
5.	Mr. Si Amphone Boutsady	Monitoring and Evaluation Officer	IFAD II
6.	Mr. Khamphone Oudomsouk	Deputy NPD	PPMU
7.	Mr. Douantha Phosisoulath	Deputy NPD	IFAD II
8.	Mr. Khamphone Sisomboun	Monitoring and Evaluation Officer	IFAD II
9.	Mr. Khamdy Pathammavong	Program Coordinator	IFAD
10	Mr. Phoutsavath Sounthala	Assistant to NPD	PFU
11	Mr. Jose Datar	Field Coordinator	UNODC

**Appendix 5.3. List of Participant of Debriefing Seminar in Vientiane
18 November 2004**

No	Name	Organization
1.	Mr. Phonxayha Yuoyia	APB, Xiengkouang Province
2.	Mr. Khamphone Sisomboun	IFAD II
3.	Mr. Jose Datar	UNODC
4.	Mr. Khamlouang Keoka	OCAA
5.	Dr. Kulwant Singh	NSRDP Hongsa
6.	Mr. Phongsamoot Khamvalvongsa	NERI
7.	Mr. Leik Bounwaat	PFU/UNODC
8.	Mr. Steven Oliver	World Bank
9.	Mr. Viengkeo Phetnavongxay	World Bank
10	Mr. Bounyadeth Phonangmal	PFU/UNODC
11	Ms. Johanna Lingren	UNODC
12	Ms. Victoria Goh	UNODC
13	Ms. Kamsene Phengphong	UNDP
14	Ms. Rie Debabrata	UNDP