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PERSPECTIVE

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Rural Finance in Lao PDR: Whither Village-Level Savings Groups?

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Given the high dependency on informal credit in rural areas in Laos, a significant policy challenge for the government is in developing sustainable semi-formal rural and microfinance institutions for villagers. This photo taken on 27 June 2018 shows Hmong tribe women posing at a coffee plantation in Houaphan province in northern Laos. Photo: Aidan JONES, AFP.

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EXECUTIVE SUMMARY

- Establishing sustainable semi-formal rural and micro finance institutions has been a critical policy goal in Laos since 2003, especially given the fact that the malfunctioning Agricultural Promotion Bank has an extremely low outreach.

- Village-level savings groups (SGs)—organised since the late 1990s as a joint venture between Lao Women's Union (LWU) and Thai NGO/governmental institutions—are semi-formal financial institutions serving the rural sector.

- Where successfully established, these SGs have become a major source of credit for villagers. However, the problem of excess funds has become a major constraint on SGs' sustainable development.

- Transfer of excess funds to outside borrowers through the building of SG federations at higher administrative levels is technically a possible solution, but its implementation has been limited in Laos.

- Initiatives undertaken by LWU to solve the excess funds problem have not worked. Instead, they have suppressed their development.

- Another type of SGs, the village banks (VBs)—organised since 2009 as a joint venture between GIZ and Bank of the Lao PDR (BoL)—has a mechanism for the transfer of excess funds to outside borrowers. However, their target is limited to poor rural areas.

- In rural Laos, it is SGs/VBs that hold good promise of becoming sustainable microfinance institutions. The reality of community-based rural organisations needs to be respected; however, their technical capacity needs to be improved.

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INTRODUCTION

About 67% of the population of Lao PDR reside in rural areas today.[1] Given the high dependency on informal credit in such areas, a big policy challenge for the government is the development of sustainable semi-formal rural and microfinance institutions. This has been a critical policy goal in the country since the early 2000s (BoL, 2003). Existing formal institutions have had limited success in rural finance; for example, the state-owned Agricultural Promotion Bank (APB), formed in 1993, has a wide branch network, but covers only 2% of borrowings by rural households (Coleman and Wynne-Williams, 2006).

One potential approach is the village-level savings groups (SGs). Overall, SGs have been quite successful in mobilising savings in rural areas, especially in Vientiane Capital. Villagers gain access to a good credit source with reasonable interest rates, and this has contributed to the elimination of usurious standing crop sales and to a decline in interest rates in informal credit. Their savings-first approach is quite different from that of mainstream microfinance such as the Grameen Bank in Bangladesh. Its strength lies instead in financial autonomy, viability and outreach with minimum cost.

This essay provides a review of the nature of and the challenges facing SGs.[2] The emphasis here is on the excess funds problem, which jeopardizes its sustainable development. If the problem can be solved in a real sense, the rural segmented financial market can be integrated into the nation-wide financial structure.

THE EVOLUTION OF VILLAGE-LEVEL SAVINGS GROUPS AND BANKS

Two types of village-based financial institutions have emerged in Lao PDR in the past three decades. These are the village-level savings groups and the village banks.

Village-level savings groups (SGs) are semi-formal rural financial institutions formed to collect savings from member villagers and lend them back to needy members with its profits distributed as dividend. The SGs were initiated in the late 1990s by the Lao Women's Union (LWU) in collaboration with a Thai NGO (FIAM: Foundation for Integrated Agricultural and Environmental Management) and a Thai governmental institution (CODI: Community Organizations Development Institute). Each LWU-SG is managed by five to six elected committee members of the village-level LWU. The major task of accepting savings and extending loans is completed within one day each month. Each member contributes a minimum of 5,000 kip (US$0.6) per month to the savings fund.

The LWU-SG movement started from rural Vientiane Capital and expanded to other rural areas. By 2009, 453 villages in Vientiane Capital (91%) had established SGs. The total number reached 3,453 in 2015. However, the number of LWU-SGs in Vientiane Capital decreased from 453 in 2009 to 397 in 2020. It is reported that 80% of them are operating actively, while the rest are facing some difficulties. About 7% of LWU-SGs have been unable to conclude their annual accounts. Of the SGs that collapsed, 6% of which returned funds to members while 8% did not.

The LWU-SGs are not the only village-level player in the rural finance sector. In 2009, village banks (VBs) were introduced by the German aid organization GIZ in collaboration with the Bank of the Lao PDR (BoL) through the *Microfinance in Rural Areas–Access to Finance for the Poor Project* (AFP).[3]

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The number of AFP-VBs reached 825 (in six provinces) in January 2020. They have a total of 360 billion kip of savings,[4] matching the 353 billion kip managed by LWU-SGs in Vientiane Capital.[5] Both are good candidates to be policy-targeted sustainable MFIs in semi-formal rural financial sector.

Since 2008, all microfinance institutions (MFIs) need to be registered with the central bank, BoL, either as Deposit-taking MFIs, Non-Deposit Taking MFIs, or Microfinance Projects. Savings and credit unions are regulated by a different set of legislation. But the number of registered MFIs in 2015 is only 53, compared to 4,815 unregistered ones. Both the LWU-SGs and the AFP-VBs are not yet registered. Of the 4,121 unregistered Deposit-taking MFIs, the share of LWU-SGs and AFP-VBs is 83.8% and 13.3%, respectively (NERI, 2015). It means that despite the endeavours by BoL, the major MFIs are not yet registered, mainly because of their ownership structure, and the difficulty of complying with BoL's accounting and financial requirements. In this respect, the BoL will need to review its regulatory requirements, taking into account the realities of community-based rural financial organisations. These realities are discussed next.

FIELDWORK INSIGHTS ON SAVINGS GROUPS

Effective promotion and regulation of rural finance require a proper understanding of the realities of this sector at the village level. Rural villages in Laos are geographically and economically very diverse. Some are located in mountainous and remote areas (e.g. along the Ou River) with no car road connections. Villages can also be found in lowland areas along the Mekong River. There are villages that are the backbone for the hand-weaving industry established by ethnic minorities migrated from northern Laos.

Some of the challenges facing the rural sector were caused by earlier government policies. Take the example of villages involved in shifting cultivation. The shifting cultivation stabilisation policy was implemented since the 1990s. It essentially prohibited the practice of shifting cultivation that was widely observed in Laos at that time. Under the policy, three plots were distributed to each household. As a result, rural households (mainly ethnic minorities)[6] which depended on shifting cultivation were forced to convert to permanent upland crop agriculture. Many, however, failed to adjust and had to migrate to other villages or towns.

For example, in an early survey conducted in late 2000s (**Table 1**), some villages were heavily dependent on cash income from agriculture.[7] For some of these, as high as 70% of cash income came from agriculture (incl. livestock and fisheries), at the same time as various non-farm job opportunities were developed in other villages.

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Table 1 Study Villages and SGs

Village	Location	Characteristic	Starting year of SG	Age of SG when surveyed	No. of HHs	% of member HHs	No. of members per HH	Total savings ('000 kip)	Savings per member HH ('000 kip)	Average loan size ('000 kip)	Purpose of loan utilization (%): Medical and other emergencies	Consumption	Education	Agriculture and livestock	Trade and business	Others
A	Vientiane Capital	Hand-weaving	2001	6	175	48.0	1.98	72,072	858	na	30.0	19.0	16.0	13.0	22.0	
B			2003	4	169	45.6	1.65	70,359	913	na						
C		Lowland paddy	2003	5	202	77.7	1.74	86,796	553	na	21.4	14.2	1.6	43.3	19.5	
D			2000	8	138	99.3	3.74	555,125	4,051	na						
E	Near Luang Prabang city	Hand-weaving	2006	4	42	78.6	1.52	39,428	1,194	1,296	56.2	14.2	0.3	0	27.8	1.5
F		Good infrastructure	2006	4	74	37.8	1.46	13,213	472	713	42.1	4.2	16.0	21.6	0	16.2
G	Ngoi District, Luang Prabang Province		2006	5	78	64.1	1.56	20,655	413	537						
H		Poor infrastructure	2007	4	61	55.7	1.29	10,015	295	417	41.1	22.3	7.1	13.5	5.8	10.1
I			2007	4	44	75.0	1.06	13,955	423	593						
J			2007	4	62	67.7	1.02	11,434	272	420						
K			2007	4	75	44.0	1.00	11,220	340	959						
L			2007	4	54	55.6	1.00	4,617	154	331						

Source: Authors.

The economic diversity of the villages is also reflected in the different levels of savings collected by the SGs across the villages. The participation rates in SGs are lower among the poorer households in each village (**Table 2**). The poor hesitate to join SGs for fear of being unable to continue monthly savings. In some villages, the mobilised savings per member household was 154,000-423,000 kip (18-50 US$) while for others, it was 413,000-4.05 million kip (49-477 US$). An important purpose of SGs loans were “medical expenses and other emergencies” and “consumption”. The other notable fact is the high dependency of households on SGs as a source of credit. Where SGs are successfully established, they become a very important source of credit for the villagers.

Our earlier survey revealed, however, that it is difficult in general for SGs to develop smoothly in remote rural areas with poor infrastructure,[8] and in rural areas without profitable investment opportunities. But the exceptions are those in areas dealing in trade business and lowland rice production. There are also inherent problems confronting SGs, notably in the form of the excess fund.

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Table 2 SGs and Rural Finance in Vientiane Capital

Village	Economic class	Average cash income ('000 kip)	Share of HHs (%)	Rate of participation in SGs (%)	No. of members per HH	% of HHs with debts	Source of credit (%)				
							SG only	SG and APB or informal	APB only	Informal only	APB and informal
A	Poor	6,128	29.1	31.4	1.25	25.5	71.8	12.7	1.4	14.1	0
	Middle	10,981	53.7	53.2	2.08	45.7					
	Rich	14,706	17.1	60.0	2.33	50.0					
	Total	10,256	100	48.0	1.98	40.6					
B	Poor	7,396	18.9	37.5	1.50	31.3	66.0	13.2	1.9	18.9	0
	Middle	19,233	45.6	45.5	1.60	33.8					
	Rich	41,146	35.5	50.0	1.77	28.3					
	Total	24,771	100	45.6	1.65	31.4					
C	Poor	5,508	29.7	63.3	1.53	63.3	51.1	31.1	8.9	7.4	1.5
	Middle	15,585	50.5	83.3	1.87	72.5					
	Rich	42,432	19.8	85.0	1.65	57.5					
	Total	17,908	100	77.7	1.74	66.8					
D	Poor	7,106	13.8	94.7	2.89	78.9	57.8	35.3	5.5	10.5	0
	Middle	13,523	50.0	100.0	3.54	66.7					
	Rich	25,902	36.2	100.0	4.34	48.0					
	Total	17,131	100	99.3	3.74	61.6					

Source: Authors.

THE EXCESS FUNDS PROBLEM

Savings groups are involved in financial intermediation. They channel funds from savers to lenders. An excess funds problem, in which the funds collected from savers exceed lending opportunities, can emerge as SGs develop. This excess funds problem has been widespread among successful SGs, and tends to appear within 4-5 years of their founding. This problem emerged as early as in the mid-2003, to reach a non-negligible level by early-2005.

There are both supply and demand sides to the problem. On the supply side, SGs can experience rapid accumulation of savings in a short period of time. This occurs when a high rate of dividend (e.g. 70% of loan interest rate: 2.1-2.4% per month) encourages villagers to increase the number of members per household and the amount of monthly savings.

On the demand side, committee members of SGs are often under pressure to meet the expectations of high dividend rates from villagers (savers). In the case of a studied village (**Fig. 1**), at first, the SG attempted to reduce its excess funds by increasing the demand for loans by reducing the lending interest rate from 4% to 3% and by allowing male members to borrow (the LWU-SG initially targeted women borrowers). The SG created demand for the funds by going into business themselves, for example starting a pig-raising business. Unfortunately, these ventures eventually failed. Finally, the SG began extending loans to businesspersons outside the village. Loan disbursements to non-villagers subsequently escalated.

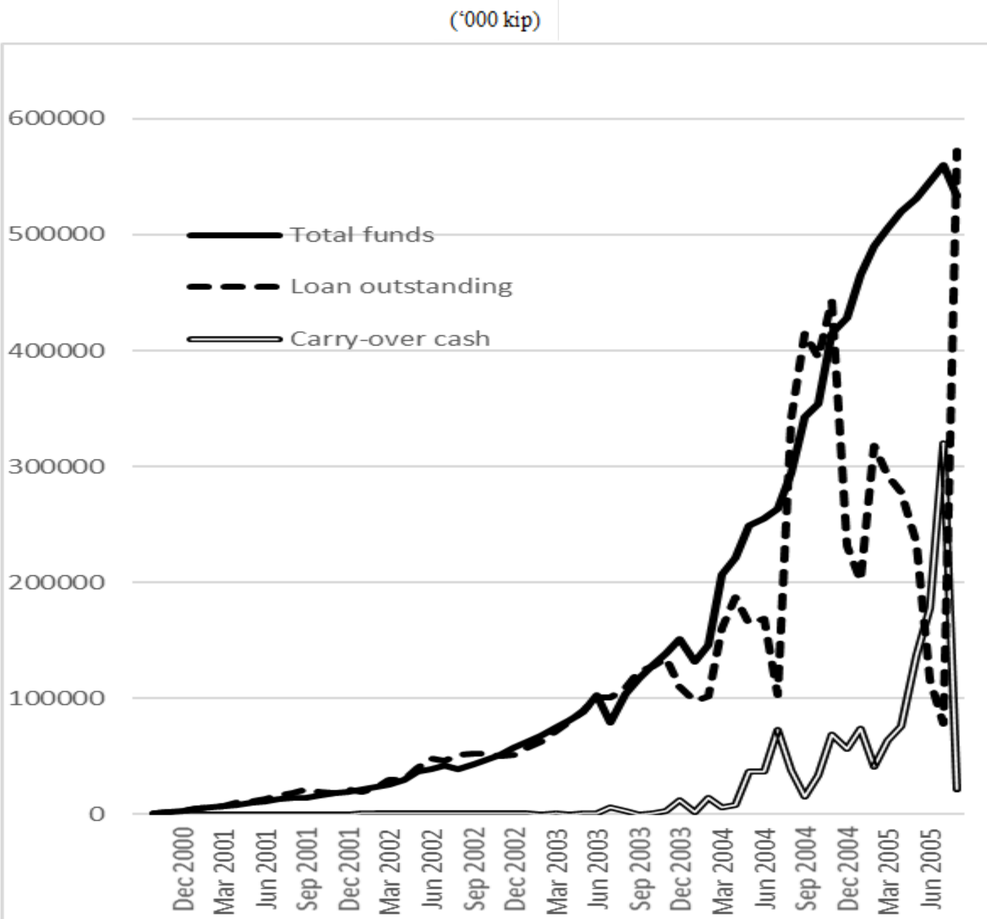

Figure 1 Development of SG in Sample Village

More problems eventually emerged when, after some time, the monthly repayment of interest experienced delays and subsequently stopped entirely. Some borrowers-entrepreneurs even stopped repayment of the principal sums. The SG was thereby trapped into a default problem by mid-2008, when 96 million kip of loans to 16 outsiders became non-performing loans (NPLs). After that, the SG ceased its activity and just focused on the recovery of their NPLs.

How should the excess fund problem be tackled? One approach is to reduce the lending interest rate to, say less than 2% per month. This would lower the rate of dividend to a level that no longer attracts villagers.

Alternatively, excess funds can be deposited in commercial banks. However, the result is similar —SGs will then cease to develop. Now, if the excess funds can be transferred to other fund-deficit SGs, the overall benefit would be very large. The experience of the Japanese cooperative movement in pre-War period—building a two-tier federation of cooperatives at prefecture and national level, through which excess funds were transferred out—can provide a good lesson for SGs in Laos.

Efforts to form similar type of federations were attempted for LWU-SGs with the establishment of district funds and a central fund in the Vientiane Capital in 2005. In the case of the district fund, only three were established, and no central fund was realised.

In 2011, FIAM/CODI, the original co-sponsors of the LWU-SG project, withdrew from the project. All SGs were then put under LWU's supervision. The LWU attempted to then solve the excess fund problem by instituting several rules. First, the maximum amount of loan was reduced from 5 times of savings to 3 times (or 25 million kip). Second, the maximum amount of monthly savings (hitherto unlimited) was introduced at 500,000 kip, or less than 10% of total savings. Third, the share of dividend to net profit was reduced from 70% to 65%. These measures effectively discouraged the enthusiasm of villagers to save in SGs.

The excess funds problem is not unique to LWU-SGs. VBs have also encountered this problem. The approach adopted involves the establishment of higher-level organisations called Network Support Organizations (NSOs) registered at BoL. VBs pay service fees to NSOs for technical services and VBs can also deposit their excess funds in NSOs at 1% monthly interest rate, which is then transferred to fund-deficit VBs (**Table 3** and **Fig. 2**). The AFP-VBs have thereby put in place an institutional mechanism to prudently eliminate the excess funds problem. However, their target is limited, and is confined to poor rural areas. Finally, it should be added that there is a necessity to substantially improve the low technical capacity of both LWU-SGs and AFP-VBs as well.

CONCLUDING REMARKS

Rural finance remains an important but challenging in Laos. In the past, village-level savings groups have played an important role in serving the credit needs of rural households. However, their future remains clouded mainly by the inability to solve the excess funds problem. Village banks have also been established but these serve a limited subset of the rural sector, namely the poor.

Compared to the mainstream MF such as the Grameen Bank in Bangladesh, both the SGs and VBs in Laos have the potential to integrate rural financial markets into a nation-wide one. This will ensure that rural savings are effectively utilised for economic development, with villagers benefiting from the interest revenues. A major obstacle in Laos is the excess funds problem. Compared to the experience of Japan, the problem lies in the big gap in interest rates between village-level and outside formal financial markets.[9] From such a perspective, it might be wise to establish an excess funds-transferring system with slightly higher interest rates than the market ones, while suppressing the 'excessive' development of SGs for the time being.

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Table 3 Characteristics of LWU-SGs and AFP-VBs

	SG model		VB model
Published	**2001**	**2011**	**2014**
Type of document	Instruction	Instruction	Instruction
Signed/Published by	Vice president of central LWU	Vice president of central LWU	AFP project
Targets/coverage	General	SGs in 7 districts in Vientiane Capital	AFP village banks
Saving			
Minimum	5,000	5,000	
Maximum	Unlimited	500,000 < 10% of total savings	
Compulsory			10,000
Voluntary			Unlimited
Loan amount			
Maximum	5 times of savings	3 times of saving Not exceeding 25 million	
Collateral required	Not identified	Loan exceeding 500,000	-
- Emergency	-	-	2 million
- Household consumption	-	-	2 million
- Trading & service	-	-	5 million
- Non-trading IGA	-	-	5 million
Loan term			
Emergency	-	Depending on members' meeting	6 months
Household consumption	-	3, 6, and 12 months	6 months
Trading & service	-		6 months
Non-trading IGA	-		12 months
Loan interest rate (% per month)			
- Emergency	2%	Depending on members' meeting	1%
- Household consumption	-	1-3%	2%
- Trading & service	5%		3%
- Non-trading IGA	-		2%
- Others	3%		-
Distribution of net profit			
Member	70%	65%	70%
Management committee	15%	10% < 6 million per person	15%
Advisory committee	-	3%	-

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Accumulated/reserve fund	10%	7%	5%
Social/village development	5%	3%	5%
LWU vertical organizations (village, district, province, central)	-	1%	-
Technical support	-	2% < 4 million (30% to district, 70% to Khet)	**
Administrative cost	-	2%	5%
Education promotion	-	2%	
Social welfare	-	5%	

Note: * Administration cost is actual to be deducted before net profit
** Technical support is actual to be deducted before net profit, payment to NSO is calculated by (loan outstanding in the period) *5/12

Source: Prepared by authors based on LWU-FCD-CODI-FIAM (2001), Central-LWU (2011), Behrle (2005), and AFP (2014)

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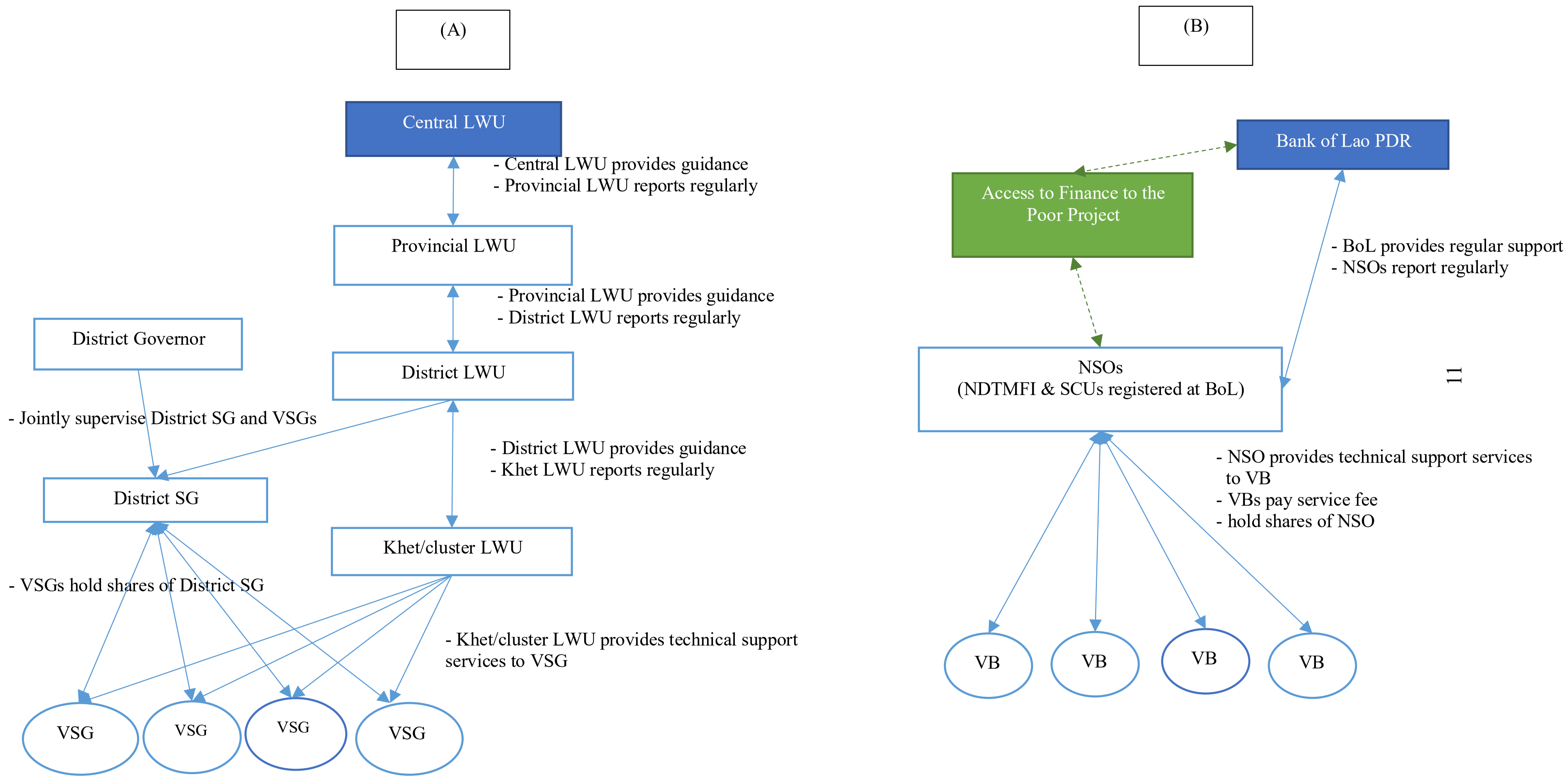
Figure 2 Organization Structure of LWU-SGs and AFP-VBs



Source: Prepared by authors based on Central-LWU (2011) and AFP (2014).

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[1] See Lao Statistical Bureau, Ministry of Planning and Investment, *Results of Population and Housing Census 2015* (https://data.opendevelopmentmekong.net/dataset/4a2c03e0-2402-4691-b2fd-56277fc95c31/resource/0be5dd3f-8f9e-4bfe-9f75-bbddc5284146/download/phc-eng-fnal-web.pdf).
[2] We draw on field research on SGs which we did in the late 2000s. For detailed discussions, see the special issue of Southeast Asian Studies at https://englishkyoto-seas.org/2015/03/vol-3-supplementary-issue-of-southeast-asian-studies/.
[3] See Prochaska et al. (2012) for more details.
[4] See Facebook's page of Access to Finance for the Poor (https://www.facebook.com/accesstofinanceforthepoor).
[5] See Vientiane Mai Newspaper on 17 December 2020, *Report on Implementation of LWU Saving Groups in Vientiane Capital in 2020.*
[6] In Table 1, H-L are basically mixed with Lao and Khmu. F is also mixed with Lao, Khmu, and Hmong.
[7] This early survey covered 12 SGs. Four are located in Vientiane Capital whereas the other two are situated in nearby Luang Prabang city, and the remaining six are in Ngoi District of Luang Prabang Province. The six villages in Ngoi District are in mountainous remote areas along the Ou River and has no car road connections. From Vientiane Capital, two are selected from the villages engaged in the hand-weaving industry (relatively recently established by ethnic minorities migrated from northern Laos), while the other two are selected from lowlands along the Mekong River.
[8] Poverty does not necessarily retard savings mobilisation, but extreme poverty seems to be an exception.
[9] Commercial banks were already extended to rural areas in Japan, and cooperatives could mobilise savings at slightly higher interest rates than the market ones.

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