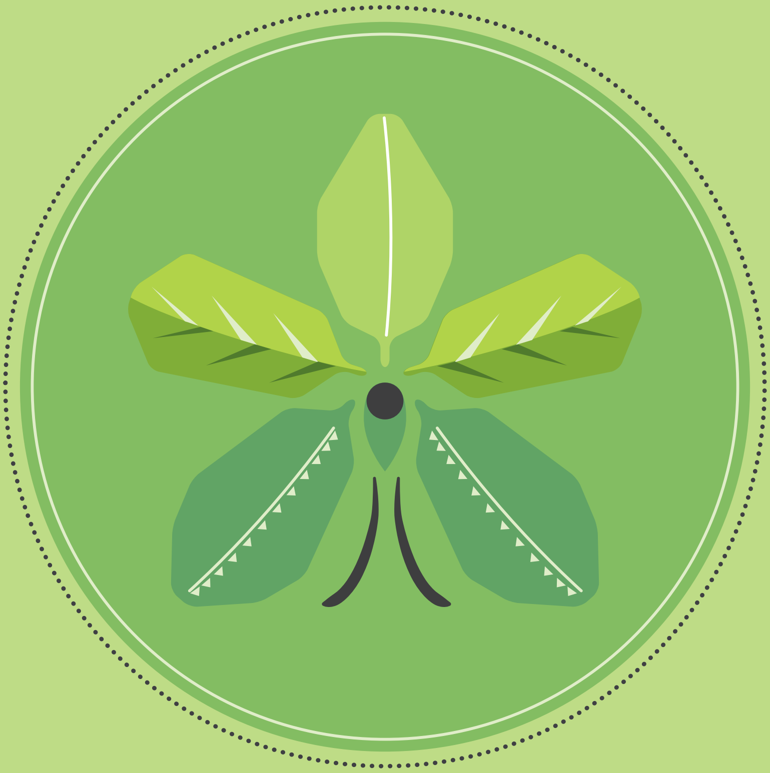
Making Access Possible



Lao PDR

Synthesis Note
2015

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PARTNERING FOR A COMMON PURPOSE

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

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

This Roadmap was initially produced by Keith Jefferis of Econsult Botswana as part of the larger MAP diagnostic work in Laos, then revised by Bank of Lao PDR through the stakeholders' consultation process.

Australian Aid

About MAP Laos

This synthesis note summarises the main findings of the MAP Lao PDR diagnostic, a comprehensive study of the scope for financial inclusion in Laos across four product markets: credit, payments, savings and insurance. MAP Laos was requested by the Bank of Lao PDR as input towards the development of a financial inclusion strategy for Laos. The Bank of Lao Financial Institutions Supervision Department (FISD) has set up a steering committee for the MAP project. MAP Laos is funded by UNCDF, and was prepared under the auspices of the Making Access to Finance (MAFIPP) project. It was agreed that the MAP study will form the basis for the development of a multi-stakeholder roadmap for financial inclusion in Laos.

This Summary report is derived from the complete Diagnostic Report and should be read together with that report. The Country Diagnostic Report is a comprehensive analysis that combines data from the demand-side, study, together with the supply-side assessment and the regulatory overview. The supply-side analysis covers payments, savings, credit and insurance, and therefore provides an understanding of financial inclusion within the broader context of Laos. The demand-side component includes an analysis of access, usage, perceptions and attitudes of financial services by target groups. The demand-side analysis draws from quantitative data provided by the nationally representative Laos FinScope Survey, carried out during 2014-15 and qualitative research in the form of Home Visits and Key Informant Interviews. Within this document (unless otherwise referenced) demographic, income and financial usage data is obtained from the 2014 FinScope Survey (henceforth referred to as FinScope). The sampling framework and weighting for FinScope is based on the 2005 national census and the 2013/14 village listing, and was developed in close collaboration with the Lao Statistics Bureau.

The MAP methodology and process has been developed jointly by UNCDF, FinMark Trust (FMT) and the Centre for Financial Regulation and Inclusion (Cenfri) to improve financial inclusion to improve individual welfare and support inclusive growth. This report was produced using the MAP Laos Country Diagnostic Report.

Authors: Keith Jefferis, drawing directly from the content of the MAP Laos diagnostic authored by Sebastian Berhle et.al.

Partnering For A Common Purpose

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

UN
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Abbreviations and Acronyms

AFP	-	Access to Finance for the Poor
AML	-	Anti-Money Laundering
ATM	-	Automatic Teller Machine
BoL	-	Bank of Lao PDR
BSD	-	Banking Supervision Department
DFS	-	Digital Financial Services
DTMFI	-	Deposit-taking Microfinance Institution
ETF	-	Electronic Funds Transfer
FISD	-	Financial Institutions Supervision Department
FSD	-	Financial Sector Development
GDP	-	Gross Domestic Product
KYC	-	Know Your Customer
LAK	-	Lao Kip
LPSI	-	Lao Postal Savings Institute
MAP	-	Making Access (to Finance) Possible
MFI	-	Microfinance Institution
MNO	-	Mobile Network Operator
MSMEs	-	Micro, Small and Medium Enterprises
MTO	-	Money Transfer Operator
NBFI	-	Non-Bank Financial Institution
NDTMFI	-	Non-deposit taking Microfinance Institution
POS	-	Point of Sale
RTGS	-	Real Time Gross Settlement
SCU	-	Savings and Credit Union
SOB	-	State-Owned Bank

SSO	-	Social Security Organization
VF	-	Village Fund

USD/Lao Kip (LAK) Exchange Rate

The average exchange rate of the Lao kip (LAK) to the US dollar (USD) was 8,050 in 2014.

Key facts

Laos has a GDP of USD 12.5 billion.

Total of 4.3 million adults.

39% of adults earn less than LAK I million (USD $125) per month

78% of adults are involved in farming

41% of adults are reliant on more than one source of income

56% of adults have only primary education or less

72% of adults own a mobile phone.

63% of adults live in rural areas

Financial Inclusion Priorities

Priority Area 1: Improving the payments eco-system through mobile money, digital financial services, and improved payments infrastructure

Priority Area 2: Extending the outreach of banks and other financial service providers, through an enhanced range of products and extended physical networks

Priority Area 3: Strengthening village funds to ensure sustainability

Priority Area 4: Improving the availability and sustainability of credit provision

Priority Area 5: Developing accessible risk mitigation products

Priority Area 6: Promoting linkages between financial institutions and sectors.

Priority Area 7: Consumer empowerment and protection

Overview of Financial Access in Laos

47% of adults reported using at least one financial service from a formal financial service provider

12% of adults use more than two types of formal financial services

64% of urban adults use formal financial services compared with 32% of adults living in a rural area without roads and **37%** of adults living in a rural area with roads

28% of adults make use of informal services only

25% of adults report using no financial services

Breakdown of Financial Access in Laos by Product Market

9% of adults borrow from a formal institution

18% of adults have borrowed in the last 12 months

33% of non-cash transactions are made through formal financial service providers

26% of adults save with a formal financial service provider,

14% adults save at home or in a secret place

26% of adults belong to a savings group

77% of adults are uninsured

Introduction

This synthesis note summarises the main findings of the MAP Lao PDR diagnostic, a comprehensive study of the scope for financial inclusion in Laos across four product markets: credit, payments, savings and insurance. MAP explores the linkages between financial inclusion and the real economy so as to impact people's welfare. It is set apart from other diagnostic exercises in that: (i) it sets a detailed understanding of the target market and their needs at the core of the analysis; and (ii) is fundamentally linked to a multi-stakeholder process towards the implementation of a roadmap for financial inclusion. The findings in the rest of this report form the evidence base for such a roadmap.

Drawing together the main findings of the Country Diagnostic Report, the summary synthesis note provides an overview of the country context and regulatory framework, which shapes the nature of the opportunities and constraints for financial inclusion. With the enabling environment in mind, the note then turns to the supply of financial services in Laos, outlining the dynamics of the market for credit, payments, savings and insurance, respectively. Based on quantitative as well as qualitative demand-side research and analysis conducted for the diagnostic, the summary note then takes a closer look at the target markets for financial inclusion: their realities, needs and current usage profile. Finally, it concludes on the cross-cutting factors driving financial inclusion in Laos, outlining seven key priorities for extending financial inclusion and, for each, suggesting potential actions to unlock the opportunities and overcome current barriers.

Country context

Lao government policy has a strong focus on balancing economic growth with poverty reduction. Economic growth balanced with aspects of societal development is the government's main concern. A focussed and systematic approach was taken with the development of the National Growth and Poverty Eradication Strategy (NGPES) in 2003, which still remains the main reference for policy decisions on poverty alleviation, which are incorporated into the five-year National Socio-Economic Development Plans (NSEDP) that shape government intervention and policy. The present 7th NSEDP runs until 2015. The 8th NSDEP for the period 2016-2020 is presently being drafted. The present National Socio-Economic Development Plan 2011 – 2015 establishes four main targets:

- Maintain high economic growth at a level of 8% *p.a.* over the period.
- Increase efforts to achieve the Millennium Development Goals (MDG) to progress beyond the country's present status as Least Developed Country (LDC) by 2020.
- Ensure the sustainability of the economic development in social and environmental terms.
- Maintain political and cultural continuity, while at the same time opening up for regional and international integration.

Small country playing a central regional role. With 6,8 million people, Laos has the smallest population amongst its Southeast Asian neighbours, and the lowest population density at 29 inhabitants per km^2. The growth rate of its population is the highest in the region, due to high birth rates in rural areas and the absence of birth regulation policies like in China or Vietnam. With such a young population, the dependency ratio is high, at 40%. However, the birth rate has decreased heavily in the last decade, leaving the country with a future 'workforce bonus' for the next decades, when a large share of the population will be of working age, and the share of dependents will decrease. Laos has been successful in turning its position as small country surrounded by the larger, and competing powers of Thailand, Vietnam and China into a role as regional mediator, buffer and link between its neighbouring countries.

The Lao economy has features that are typical for a country in transition. Political and monetary stability have contributed to high and sustained economic growth. For a number of years, growth has been based on the exploitation of natural resources, minerals, wood and hydropower, but recently the agricultural and services sectors have made a larger contribution. The domestic currency, the Lao Kip, is stable, due to strict management by the central bank. However, many people still prefer to borrow in US dollars or Thai Baht because of the lower interest rates charged, but may be unaware of the exchange risk inherent in these loans. Previous years have seen a widening of the fiscal deficit caused by large public investment programs and a massive increase in public servants' benefits and a weakening of the state revenue because of falling gold prices. This deficit has been reduced due to subsequent cuts in public spending, and is aimed at not exceeding 5% of GDP.

Lao society builds on clan and village community. The family, often living under the same roof with other members of the extended family, is the basic economic labour- and income-sharing unit. The extended family remains the main reference for social security, professional networking and for basic financial transactions. Although the traditional cohesion - especially within rural communities - has undergone dramatic changes caused by relocation, migration patterns, cultural changes and political interference, it remains a strong factor.

Destitute poverty is rare in Laos, but poor people's livelihood remains fragile. The rural population is highly vulnerable to natural disasters, especially as climate change is thought to be responsible for the increasingly erratic rainfall pattern in recent years.

Poverty in Laos is strongly correlated with rural areas and with ethnic origin. The poverty rate is almost three times higher in rural than in urban areas. As rural areas account for 63% of the Lao population, the overwhelming majority of the poor are rural residents (88 %). There is a strong correlation between poverty and those ethnic groups that traditionally have been dwelling in remote rural areas. Often due to their remote location, ethnic minority populations have comparatively less access to markets and public services such as health, education, agricultural extension and communication and road infrastructure. The central government's attempts to improve the living conditions in rural areas has led to substantial changes in the livelihood of the affected population but much remains to be done

Key Environmental Factors for Financial Inclusion

What drives financial inclusion in any environment is determined by what consumers need and what providers are able and willing to provide. The nexus between supply and demand is the central foundation of any market, but these both exist within an overarching environment that shapes the needs of consumers and shapes and constrains provision. This section looks at the demand and supply for financial services in Laos within the contextual environment in which they coexist. This allows the identification of unmet needs that can feasibly be addressed with the Laos environment. The following paragraphs highlight the national context of Laos, and the financial services sector, in order to identify the key potential opportunities for increasing access to finance.

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

Lower middle income country with declining, but still high, poverty rates. GDP per capita is around US$1,600, one of the lowest in South-East Asia. Poverty has declined substantially over the past two decades, but remains high at 23%. Income distribution is reasonably equal, with a Gini coefficient of 0.36, similar to other countries in the region, but inequality has risen slightly in the past decade. Access to education and health services is poor.

Farming the main occupation. The population is mostly engaged in farming, and in many cases have limited integration into the formal, monetary economy. 78% of Lao adults receive some income from farming activities, and for 52% it is their main income source. Perceived financial needs are often modest and there is a low level of financial literacy.

Socialist political system, strong government, small private sector. The highly centralized political system entails a leading role for state-led development. State-owned enterprises occupy an important position, including in the financial sector. The private sector is relatively small. However, there has been movement towards market-led development and the need for a stronger private sector is accepted by Government.

Strong growth, led by mining, energy and infrastructure projects. Economic growth has been strong, around 7-8% in recent years. Although agriculture is the dominant activity for the majority of the population, growth has recently been driven by major investments in mining, hydroelectric power projects and infrastructure, with foreign direct investment playing an important role. Rapid growth has been associated with urbanization and the integration of more of the population into the formal, modern economy, with associated demands for financial services.

Social cohesion high, along with ethnic diversity. Community is very important in Laos and there is a high level of social cohesion. This provides the basis for community-based financial institutions. Social solidarity networks are important in managing risks. There is a high degree of ethnic diversity, which has an important influence on behaviour.

Poverty alleviation a high-level objective. There is a strong government focus on rural development and poverty alleviation. This provides a conducive environment for the development of a financial inclusion policy, which is seen as potentially playing a strong poverty alleviation role. It has also led to a reliance on subsidized credit provision, which is expensive and may not be effective.

Access to infrastructure is good. More than 90% of adults live in households that have access to electricity. However, only 43% have access to piped running water. Most of the rural population have access to all-weather roads. Mobile phone penetration is very high.

Macroeconomic position has risks. Despite good growth, the macroeconomic position is exposed to several risks. In particular, external debt is high, and foreign exchange reserves are low, leaving the country exposed to external shocks. Furthermore the fiscal deficit is high, and there is a need to rationalize spending, and cut unproductive spending. This means that any government resources used to support state-owned banks or provide subsidised credit must be effectively targeted and efficiently delivered.

Overview of the financial sector

Financial sector in transition. The financial sector has traditionally been dominated by the large, state-owned commercial banks, which in the past have not been very dynamic or competitive. However the sector has grown rapidly in recent years, with new institutions established, new products and services introduced, and much more competition. However, the small population and low population density limits the number of financial institutions that can sustainably offer formal financial services. The financial services landscape is comprised of the following institutions.

Banking sector. The formal financial services sector is dominated by the state-owned banks, Banque pour le Commerce Exterieur Lao (BCEL), Agricultural Promotion Bank (APB) and the Lao Development Bank (LDB). However, there is an increasing number of private banks, which includes joint ventures between private investors and state entities, domestic privately owned banks, and subsidiaries and branches of foreign banks. The share of state-owned banks in the market has been shrinking as new competitors have entered. Banks are mostly focused on urban areas. Besides normal banking (deposit-taking and credit) services, banks also provide a low-cost over-the-counter money transfer service, and act as agents for cross-border money transfer operators such as Western Union and Moneygram.

Development Finance Institution. There is one stated-owned DFI, Nanyobay Bank. Although it is not a deposit-taking institution, it is generally included in the banking sector. Nanyobay Bank is used as a primary conduit for policy-based subsidised credit to farmers.

Non-bank financial institutions. The NBFI sector has been growing, albeit from a small base, mainly through MFIs and leasing companies. While they are mostly urban, they are extending outreach to some extent to rural areas. MFIs provide both savings (deposit-taking) and credit services, while leasing companies only provide credit. There are also some regulated pawnshops. The Lao Postal Savings Institute (LPSI) provides savings services. In terms of overall significance, formal NBFIs remain relatively small.

Insurance. The insurance sector is not well developed in Laos, and is concentrated on compulsory (although not well enforced) vehicle insurance. There is a dominant insurance company (AGL) and a number of smaller providers. There are various state schemes for social insurance.

Savings and Credit Unions (SCUs). There are a small number of SCUs, most of which have developed from village funds.

Informal providers – Village Funds (VFs). Informal financial service provision is extremely important in Laos. The primary informal organisations offering financial services are Village Funds (also known as Village Banks), of which there are a very large number (estimated at 4,000-6,000). VFs accept deposits and many also offer credit to members. VFs are present in most villages, and are officially promoted by the Government as part of the "Developed Village" policy. They tend to operate on a part-time basis with semi-formal procedures.

Other informal providers. There are a number of other informal sector providers that provide coverage in Laos, especially in rural areas to low income households. These include rotating savings and credit associations (Lin Houai), informal leasing by retailers and travelling merchants, and informal money lenders. In addition, funeral funds provide community-based risk pooling.

Mobile money. Pilot mobile money services are currently being rolled out. Three pilot schemes have been licensed, including one bank product (from BCEL), and two from mobile network operators (Unitel and ETL). While these will initially operate on a limited scope basis during the pilot, it is anticipated that they will quickly roll out nationwide coverage.

Post Office. Lastly, the Post Office provides remittance and bill payment services.

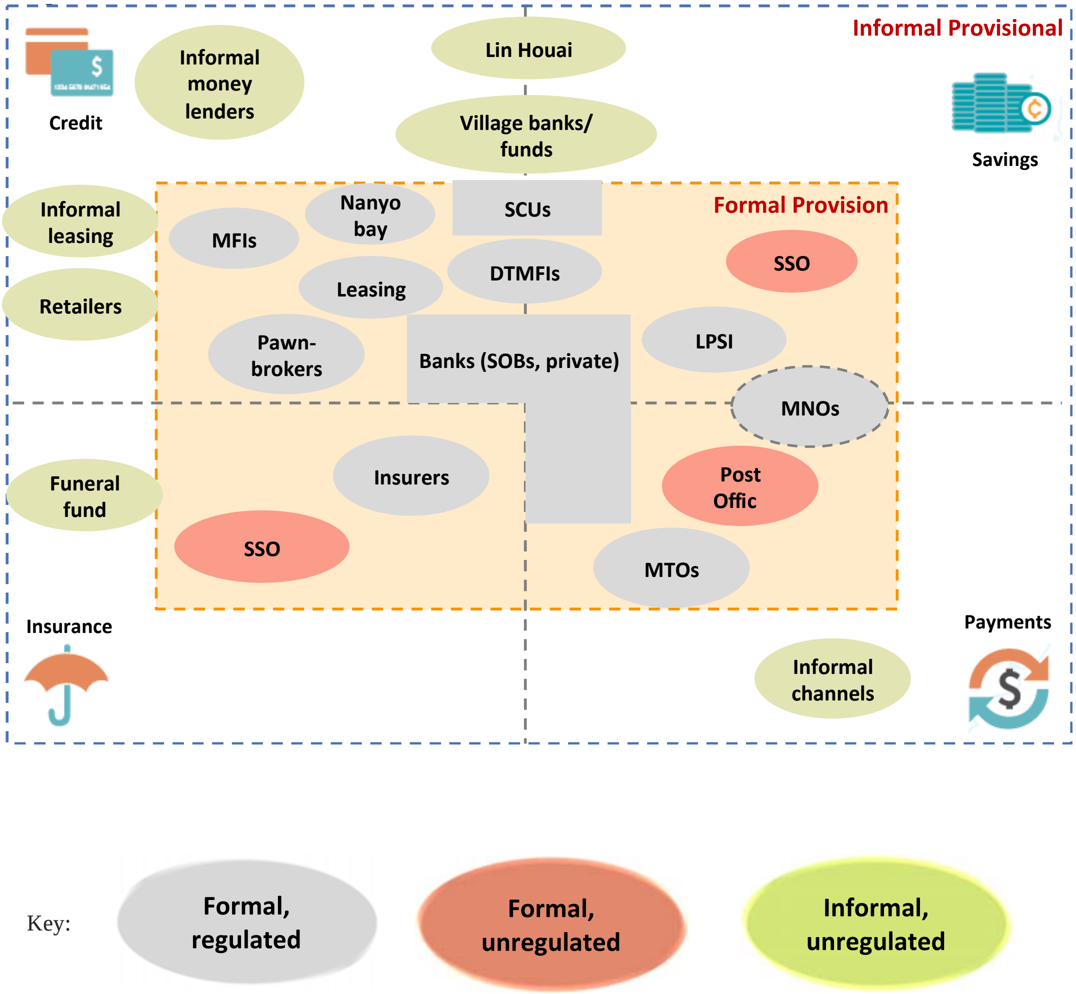
Financial sector infrastructure is not well developed. There is a real time gross settlement system (RTGS) for high value payments, but it is not widely used. There is a cheque clearing house operated by the BoL, but none for EFTs. Interbank transactions are settled bilaterally. There is no national switch for domestic payments, and many transactions are settled through Visa, However, the Chinese firm UnionPay is in the process of establishing a national switch that will acquire ATM transactions. The banks dominate the remittances market. Mobile money is only just starting, on a pilot basis. There is a credit information bureau at the BoL but it is only open to banks, and is reportedly not very efficient or comprehensive. There is also a deposit protection scheme run by the BoL, but this is used only by banks and not other deposit-taking institutions.

Industry associations exist but are limited. There is a Bankers Association, but it is not very active. A Microfinance Association acts as an umbrella organisation for the MFI sector, and deals with research, capacity building and donor relations. There are no cross-cutting associations, such as credit providers or payments service providers.

Development partners have been active in promoting access to finance and financial sector development more generally. The development of village funds, in line with government policy, has been to some extent donor-led. GIZ has been particularly active through the Access to Finance for the Poor (AFP) project, which includes institutional development, and network support organisations. AFP also has a component dealing with Financial Literacy and Consumer Protection. Donors have also supported the development of SCUs and MFIs. The Asian Development Bank (ADB) has helped policy and institutional development in the banking and MFI sectors; KfW ahs provided a fund for commercial banks to on-lend to MSMEs, while the International Finance Corporation (IFC) is supporting the development of the national payments system and the credit bureau. The World Bank is supporting the BoL Banking Supervision Department on prudential regulation and performance indicators.

The diagram below summarises the financial service provider landscape across the four product markets, namely credit (top left), savings (top right), payments (bottom right) and insurance (bottom left). It differentiates between formal (regulated) and informal (unregulated) providers, with informal providers situated in the outer segment:

Figure 1: Representation of Lao Financial Sector



Source: MAP Laos Country Diagnostic Report, 2015

Regulatory framework

Bank of Lao the main regulator. Almost all financial sector regulation falls under the Bank of Lao (BoL), and is divided between the Banking Supervision Department and the Financial Institutions Supervision Department. FISD is responsible for micro-finance institutions (MFIs), Savings and Credit Unions (SCUs), mobile money and leasing companies. The BoL is also responsible for the regulation of capital markets. Regulatory responsibility for insurance falls under the Ministry of Finance, which is also responsible for general financial sector development policy. Regulatory directives may also be issued by other arms of government, such as the Prime Minister's Office.

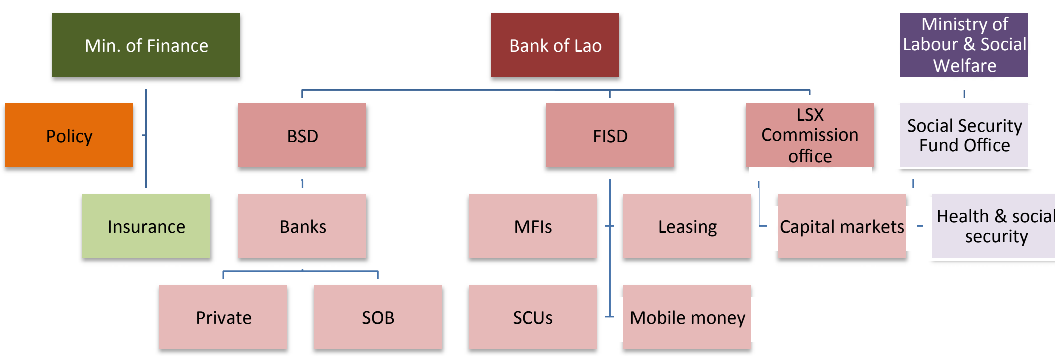
Generally enabling environment, but there are many gaps, and modernisation is needed to extend inclusion. The regulatory environment is generally supportive of financial sector development. However, there are gaps and inconsistencies, and in some respects the regulatory and policy environment is lagging behind financial sector development and innovation. The process of regulatory reform is very slow, and laws and regulations often remain in draft form for long periods. There are uneven regulatory requirements across different types of financial institutions, e.g. between banks and MFIs, which create a playing field that is not level, and discourage growth. Regulations discourage the opening of new branches by banks, MFIs and leasing companies, for instance by imposing additional capital requirements on institutions when new branches are opened, which inhibits financial inclusion.

Village Funds are unregulated. An important component of the financial sector – Village Funds – is unregulated. A large proportion of village funds are thought to be unsustainable and there is potential risk to depositor/member funds. Furthermore some of the more successful village funds have grown quite large. There are risks from having such a large segment of the financial sector operating without appropriate rules and supervisory structures. Some Village Funds have received intensive support for development, operational activities and capacity building, which appears to have benefits that are potentially generalizable.

Supervision and implementation of regulations is patchy, and there is a lack of financial sector transparency. The implementation of regulations and supervision across the financial sector is patchy, with a high level of regulatory forbearance that undermines the credibility of regulation and supervision. Comprehensive information is lacking on the regulations, rules, guidelines and directives applicable to financial institutions. Different entities interpret regulations and directives in different ways. There are also gaps in the information made available by both the regulators and financial institutions themselves.

Regulatory provision for consumer protection is generally weak. Certain practices are permitted that appear to disadvantage consumers, especially those with low levels of financial literacy; these include flat rate interest on loans (rather than declining balance), and the appropriation of dormant account balances to banks' profit and loss statements. Banks are not obliged to have well-publicised systems for resolving customer grievances, nor is there and independent dispute resolution mechanism.

Figure 2: Financial Sector Regulatory Institutions



Source: MAP Laos Country Diagnostic Report, 2015

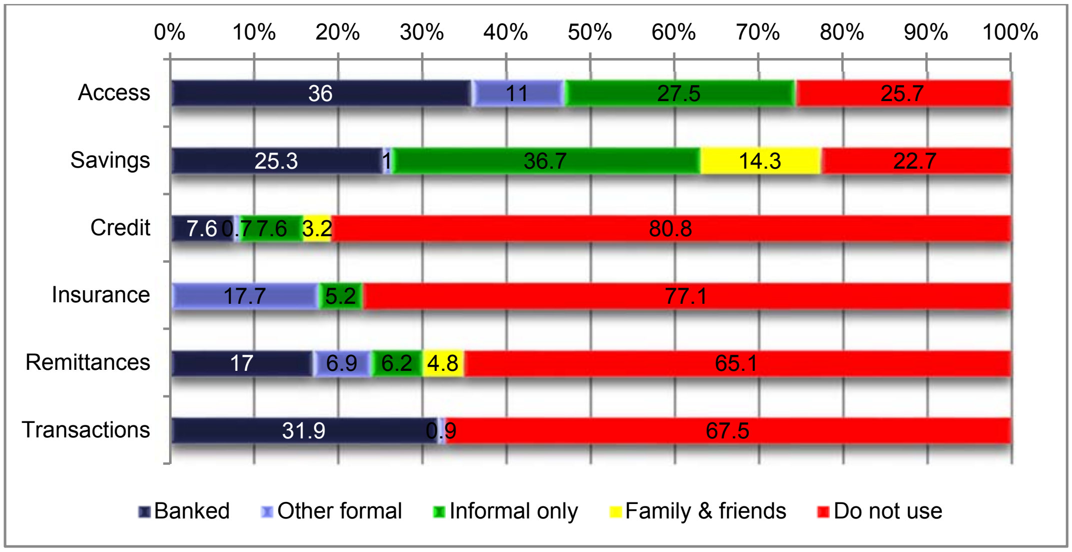
The Lao consumer

Access to formal financial services is moderate. Just under half (47%) of Lao adults are formally served. A further 28% use informal services only and 25% are totally excluded. This is midway amongst the three countries in the region where there have been FinScope surveys. In Thailand, 97% of adults have formal access and only 1% are financially excluded. In Myanmar, only 30% are formally included and 39% are financially excluded.

Informal financial services are more widely used than formal services. 61% of Lao adults use informal financial services. Many adults, 33% of the total, use both formal and informal financial services. Informal financial services therefore provide a complementary channel to those who use formal financial services, and also extend the frontier of access for those who do not use formal products.

Wide variation in usage of different types of financial services. FinScope surveys consider usage of four groups of financial services: (i) savings; (ii) credit; (iii) insurance; and (iv) payments. The last category is in turn divided into (a) transactions, referring to the purchase or sale of goods and services, payment of wages etc., and (b) remittances, whereby money is sent or received across a distance. FinScope reports results for usage of these financial services in terms of the access strand, which considers the types of providers, specifically: those who use any type of bank products; those who use only products from other formal, regulated financial service providers; those who use only informal (unregulated) products; and those who use only family and friends. The final group is those who are financially excluded, who do not use any of these types of financial products and services.

Figure 3: Financial services access



Source: FinScope 2014

As shown in the figure above, usage is spread as follows across product markets:

- Only 8% of adults use formal credit. 9% solely make use of informal credit and a further 4% only borrow from family or friends. Around 80% of adults do not use any credit;
- 24% of adults use formal remittance products and a further 14% use informal products only and family and friends. Most remitters send money through bank channels. 65% of adults do not send or receive remittances;
- Savings accounts are the formal products that reach deepest into the adult population; 26% of adults save in formal institutions. However, most adults save in informal savings groups – 53% of the total – and 37% save at home, mainly through cattle/livestock, jewellery or gold. Only 38% of adults do not save in any way;
- Formal insurance reaches 18% of adults. 5% of adults use informal insurance (such as a funeral fund) without having formal insurance cover. 77% of adults are without any explicit risk cover, meaning that most adults use savings as a mechanism to manage risk;
- Usage of banking for transactions is quite high, at 31% of adults. Nevertheless, there is a strong preference for cash, even to make large payments.

- There is a clear variation in access levels across settlement types, with 80% of urban adults enjoying access to finance, compared to 72% of adults in rural areas with roads, and 63% in rural areas without roads.
- While access to finance is quite deep, with reasonably high financial inclusion, it is not very broad. Only 29% of adults use more than one formal financial product category (i.e. savings, credit, insurance and payments), while 17% use only one formal service, and 28% only use informal products.

Credit provision is limited, and is the least-used financial product. The banks tend to focus on collateral-based lending, and have not developed cash-flow or payroll-based loan products. Loan maturity tends to be short (5 years or less), and some banks have concerns about the effectiveness of legal processes for loan recovery, even when there is collateral, which adds to perceived risk. The credit information system is weak. Commercial credit provision is also inhibited by restrictions on loan-deposit spreads, which makes it difficult to price for risk. A substantial proportion of credit is provided as state-subsidised "policy loans", notably to farmers. Although data on this lending is poor, there appear to be low repayment rates. Easy access to subsidized credit, combined with weak follow-up on repayments, is through to have undermined the "credit culture" and makes it more difficult for commercially-focused credit providers to enter the market. It is notable that low-income groups tend to have much higher debt-to-income ratios than higher income groups.

Insurance is also not widely used, in part because it is not well understood. Lao adults use a variety of means to manage risk, including savings and access to emergency short-term credit. Formal insurance products are, however, not always easy to understand for those with limited financial literacy.

Usage of financial products varies according to various demographic, economic and locational characteristics. The likelihood of an adult using financial services depends on a wide range of factors, including income level, gender, age, location of residence and level of education. Of these, the most important appear to be income and education, followed by location, with less variation by age and gender.

Figure 4: Access to finance by income

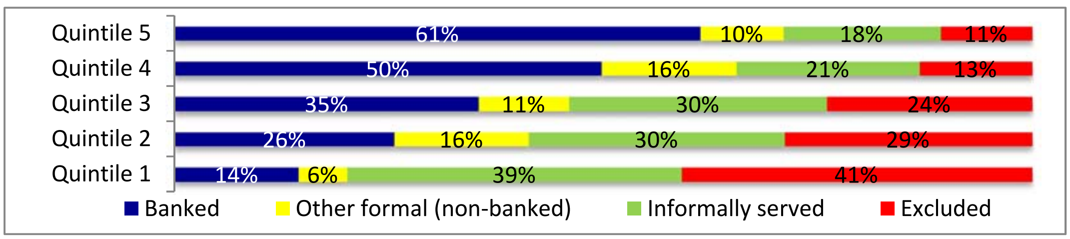


Figure 5: Access to finance by level of education

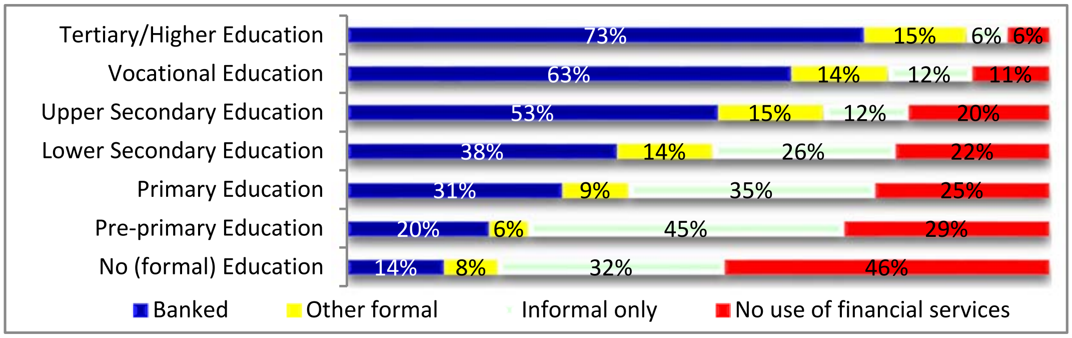


Figure 6: Access to finance by location

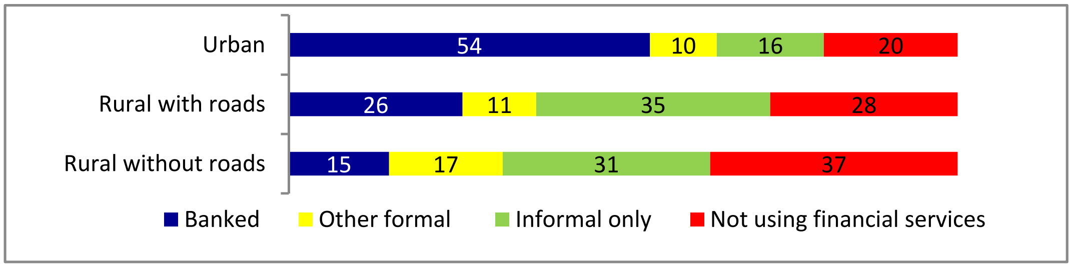


Figure 7: Access to finance by age

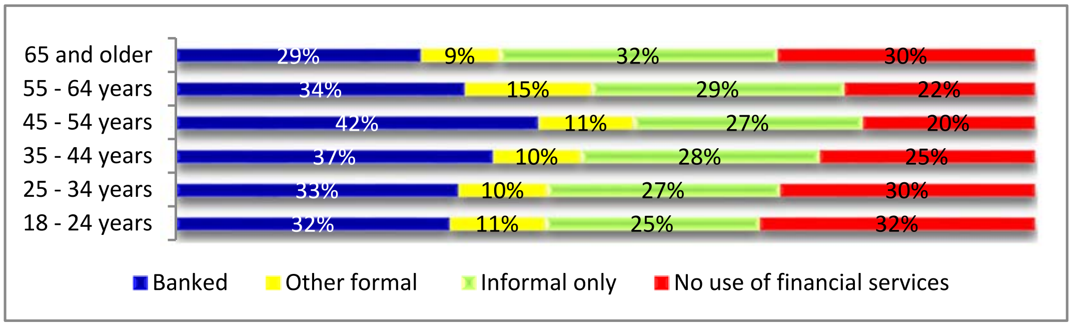
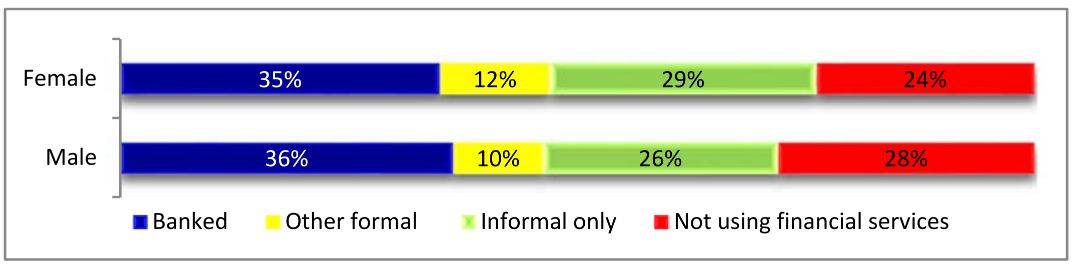


Figure 8: Access to finance by gender



A number of usage and access barriers. There are a variety of reasons for low usage of some financial products. For the few adults who do not save, the main reason is that they do not have enough money, or their income is too low. For those who do not use credit or insurance – the majority – the main reasons are a lack of need, a lack of appreciation of the attributes of financial products, and a lack of understanding of how they operate. There is also a substantial fear of debts. Even should they choose to use formal financial services, many consumers face access barriers, notably low affordability, a lack of flexibility and distances to access branches and distribution networks.

Segmenting the market

Not all Lao face the same realities or have the same needs. In order to generate a more nuanced understanding of financial inclusion across the population, the analysis segments the adult population into discrete target market groups based on their main source of income and the level of their income. The members of each group share a number of similar traits and are likely to have similar constraints and needs where financial inclusion is concerned.

The Lao adult population was initially segmented into five target groups, as follows:

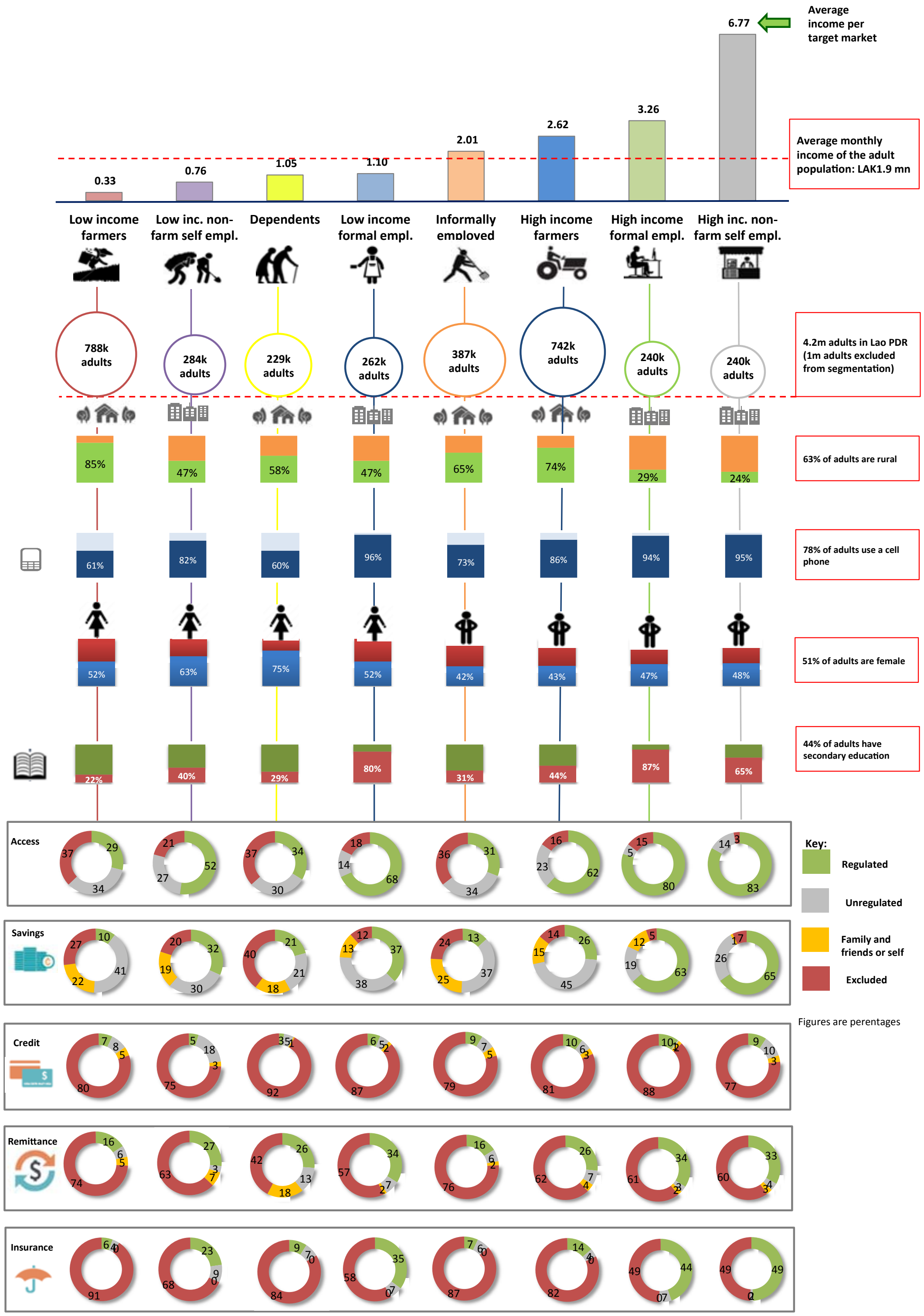
The profile of each is summarised below:

- The **Formal Employee group** includes government and formal private company employees – those who receive a regular wage or salary from employment.
- **Informal employees** are those earning wages and salaries from employment by a private individual, employment on a farm and those that earned income from piece jobs.
- The **Self-employed (non-farm) group** includes adults who are self-employed in formal or informal enterprises, i.e. those who trade non-farming goods and services, or who make goods to sell. The group also includes those who mainly earn an income from money lending, or from renting out land, property, or equipment.
- **Farmers** are those adults whose main income comes from selling their own farm produce, whether crops or livestock, or from selling items that they collect from nature. The farming group accounts for over half of all adults.
- **Dependents** are adults that receive money from someone else in the household, other family/friends or the government (e.g. pensions).

The three largest groups all encompassed a broad range of adults with differing income levels, access to finance and demographic characteristics. Hence they were then divided into high-income and low-income sub-groups in order to achieve a greater degree of similarity within groups. The groups sub-divided in this way includes farmers, formal employees and the non-farm self-employed, giving eight groups in total.

The diagram below shows the demographics and levels of financial services access for each target market.

Figure 9: Target Market for Financial Inclusion in Laos



Source: FinScope, 2014

High-income non-farm self-employed. This is a small group (7.6% of adults), predominantly urban, well educated, and older than the average. It is has the highest income of all target groups, the highest level of financial inclusion, and is highly banked. The group is already well-served financially, but is of medium priority from an inclusion perspective, as it is key for MSME development. Despite their role as MSME entrepreneurs, only 23% of this group uses credit. The main financial needs of the group are for cheap, reliable payments / remittance channels (as senders to dependents), and for financial products specifically designed for MSMEs. They have a potential need for housing finance, , and long term savings (asset accumulation, retirement).

High-income formal employees. This is also a small group (7.6%), well educated, mainly urban, and younger than the average. They are relatively high income, are well-served financially, and have high access to banks. They are not a priority from a financial inclusion perspective as their needs are largely being met. Their main needs are for bank accounts as a channel to distribute other financial services, and they have a potential need for housing finance and long term savings. They therefore also benefit from enhanced remittance services and sophisticated banking products using cell phone and internet (given their existing access to this infrastructure).

High-income farmers. This is a large group (23.4%), mainly male, and relatively well educated. They are moderately well served financially, but mainly use informal financial services, and are underserved formally due to distance from financial services. They have a high level of savings but could benefit from a broader range of savings products. A high priority group whose main needs are credit for agricultural inputs, which needs to be structured so as to suit agricultural cash flows; short-term liquid savings for consumption smoothing of seasonal income; and longer-term, less liquid savings for assets and retirement, and to provide an alternative to savings currently held in non-financial forms. They could also benefit from improved access to insurance, for assets (housing, vehicles), health and credit.

Informal Employees This is the largest non-farm group (12.2%), and is relatively young and male, with medium income. However, they have low access to finance, are mostly unbanked, and mainly make use of informal financial services. The group is high priority with regard to financial inclusion. Their main needs are ways to save irregular incomes, and for low value-low cost financial products, including liquid savings instruments to provide a buffer for income instability. In general they would benefit from broader choices and more formal access.

Low-income formal employees. This is also a small group (8.3%), mainly female, well educated, mainly urban, and younger than the average. They are relatively high income, are well-served financially, and have high access to banks. They are medium priority from a financial inclusion perspective; although their needs are being met to some extent, they could potentially benefit from greater access to financial services. Their main needs are for bank accounts for payroll receipts, and perhaps as a channel to distribute other financial services. They have a potential need for housing finance and long-term savings. Leasing, if not used excessively, may be suitable for households that lack the financial discipline to set aside income for the purchase of higher-value items

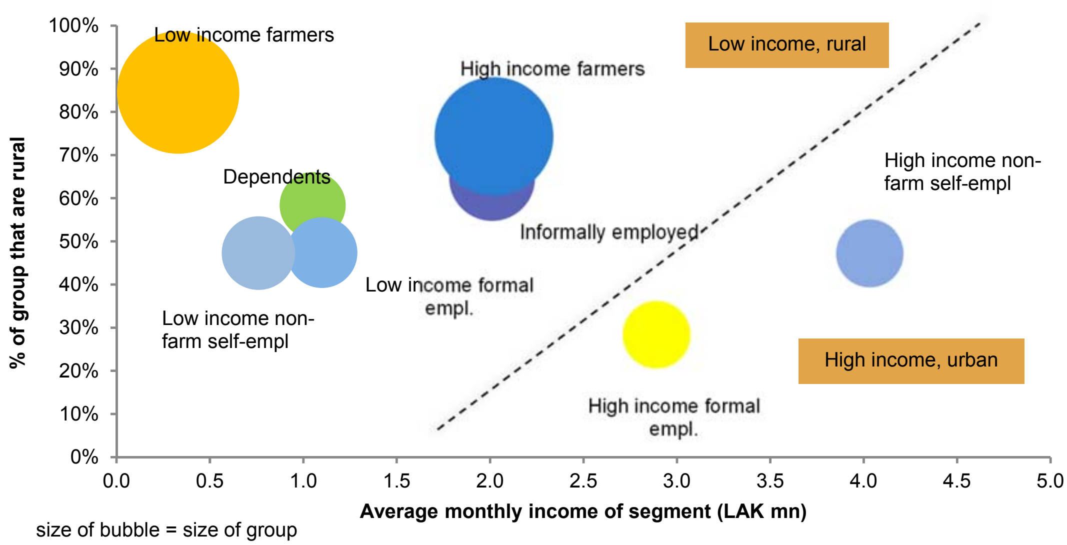
Dependents This group has low income and is mainly urban, female and elderly. It is the smallest group (7.2% of adults). They have low access to finance, and are mostly unbanked, and to the extent that they use financial services these are mainly informal. This is a high priority group with regard to financial inclusion. Their main needs are to have broader choices, including more formal access. They could benefit from low value-low cost financial products, liquid savings instruments, and access to low-cost remittances for rural dependents. Affordable health insurance would also be useful. However, their financial capability is low, so products need to be suitably designed.

Low-income non-farm self-employed. A small group (9.0%), not well educated, mainly urban and female. Low income but reasonably well served financially, both banking and informal. The group is high priority from an inclusion perspective. Their main needs are for cheap, reliable payments / remittance channels and for formal savings products. They would also benefit from credit products that focus on cash flow rather than on collateral, and with repayment schedules fitting into the cash flow patterns of MSMEs.

Low-income farmers. A large group (24.8%), with very low income. Mainly female, and not well educated. They have a low level of financial inclusion, are largely unbanked, and usage is mainly informal. They have limited integration into the market economy, which limits their demand for financial services. This is a high priority group with regard to financial inclusion, but have limited financial capacity. Their main needs are credit for agricultural inputs – although this needs to be carefully provided so as to avoid unsustainable borrowing; short-term savings for consumption smoothing of seasonal income, and emergency loans.

As Figure 10 shows, the majority of the population fall into the target groups that can be broadly characterized as “rural, low-income”, with a small minority characterized as “urban, high-income”.

Figure 10: Characterisation of Target Groups by Income and Urban/Rural



Source: FinScope, 2014

Cross-cutting trends and drivers of financial inclusion

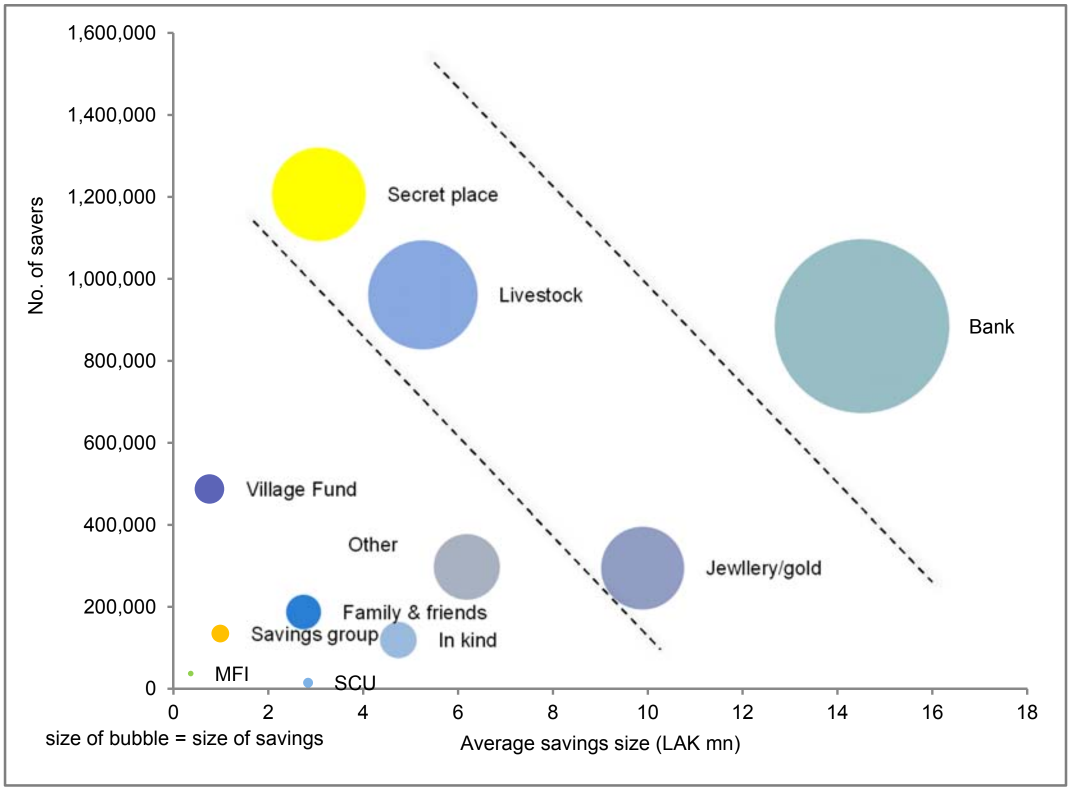
Access to financial services is mainly driven by informal and semi-formal providers rather than the formal sector. For many Lao households/adults, especially those who live in rural areas (the majority), their primary point of contact is with informal or semi-formal financial service providers, particularly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

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

Financial access depends on a variety of factors that must be taken into account in designing inclusion strategies. It is striking that the four target groups with the lowest average monthly incomes are predominantly female, and that the three target groups with the lowest level of access to finance – whether formal or informal – are predominantly rural. More generally, financial inclusion is low for those with low incomes and little education.

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

Figure 11: Savings by type of institution, number of borrowers and amount,



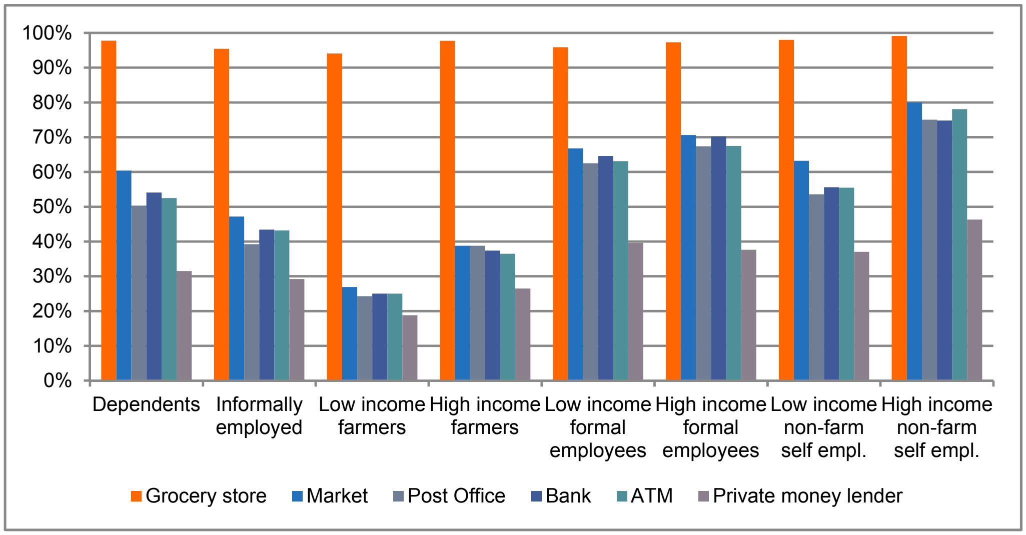
Source: FinScope, 2014 and supply-side consultations

Banks will play an increasingly important role. Banks dominate the financial sector, as they are the institution with the largest number of customers as well as the largest pool of financial assets. Banks have also grown rapidly in recent years and extended their customer base and product offering. In the future, banks are likely to play a leading role in extending financial inclusion, as this process continues, and as more people move into the formal economy and urban areas. Competition will be the main driver of this process.

Bank branch outreach. The physical outreach of banks through branches and service points is limited to urban areas and district centres, and it is unlikely that it will be economically viable for banks to extend their physical networks significantly beyond this. Non-branch channels will be needed to reach rural customers.

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

Figure 12: Proximity to services: % of group with access in 30 minutes or less



Source: FinScope, 2014

Technology provides a means of overcoming the impediments of distance, low population density, and limited access to bank infrastructure. Given that the banking system is unlikely to extend financial service provision to less populated areas and low-income households through physical infrastructure, technology can help to fill the gap. Technology-based provision of financial services is at an early stage in Laos. However, there is significant potential to use technology-based services such as mobile money and cash acceptance networks to extend access beyond branch-based provision.

Agent-based financial service provision holds promise, but is as yet untested on a large scale. As noted above, grocery stores are widespread and most of the adult population has ready access to them. Many of them could potentially be agents for financial service providers. Early demand is likely to come from mobile money networks, but this could in due course be extended to banking agents (either independently or in collaboration an MNO). Banks targeting down-market may find this more useful, e.g. Acleda Bank. In the medium term, agents could also be used by the larger village banks, but this would require more formalisation of their status and upgrading of technology and management systems.

Education, awareness, financial literacy. Uptake of financial services is limited by a low level of awareness and understanding of what they can offer. In the long-term, improved financial literacy will be an essential component in extending access to finance, so that people are empowered to make appropriate choices from the options on offer.

Greater modernisation is needed to extend inclusion. The regulatory environment is generally supportive of financial sector development. However, there are gaps, and in some respects the regulatory and policy environment is lagging behind financial sector development and innovation. Without modernisation, the regulatory framework will increasingly be a drag on financial inclusion.

Financial inclusion priorities

Identifying priorities. The Country Diagnostic Report identifies a number of gaps and opportunities to extend financial inclusion in each of the four product markets. As a basis for the roadmap, this section concludes on the key financial inclusion priorities and provides strategic recommendations for unlocking each priority.

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

Priorities identified based on needs and potential reach. The key financial inclusion priorities are identified in Figure 13. It shows the potential for deeper reach of different financial services in each of the various target market segments (grey shading, with darkest shading indicating largest potential), as well as the number of people and average income of each segment. To the right it indicates the estimated potential clients that could be impacted for each financial service type and the welfare impact that could be had from that service based on the various impact transmission channels. On this basis, the likely impact is ranked as high (green shading), medium-level (yellow) or low (red).

Figure 13: Priorities Matrix

Products		Dependents	Informally employed	Low income farmers	High income farmers	Low income formal empl.	High income formal empl.	Low inc. non-farm self empl.	High inc. non-farm self empl.	Est. potential clients ('000)
% of adults		7.2%	12.2%	24.8%	23.4%	8.3%	7.6%	9.0%	7.6%	
average income		1.05	2.01	0.33	2.62	1.10	3.26	0.76	6.77	
Credit	Personal loans	5%	15%	15%	10%	5%	10%	15%	15%	507
	Asset	5%	0%	5%	0%	0%	0%	5%	5%	104
	Housing	0%	0%	5%	0%	5%	5%	5%	0%	106
	Productive credit	5%	15%	10%	20%	5%	5%	15%	15%	538
Savings	Retirement	5%	15%	10%	15%	15%	30%	15%	20%	620
	Low cost savings	40%	70%	60%	75%	65%	65%	65%	50%	2,718
	Healthcare	60%	70%	75%	85%	70%	70%	65%	75%	3,152
	Education	10%	20%	25%	50%	35%	40%	30%	30%	1,361
	Capital accn	5%	20%	25%	35%	20%	35%	15%	40%	1,102
Payments	Payments	40%	50%	20%	40%	60%	60%	60%	75%	1,869
	Remittances	60%	25%	25%	40%	45%	40%	35%	40%	1,528
Insurance	Asset	45%	55%	65%	70%	50%	60%	65%	70%	2,654
	Health	20%	25%	15%	20%	15%	20%	30%	25%	862
	Crop	25%	55%	60%	60%	40%	15%	25%	25%	1,961
	Credit	5%	10%	5%	10%	5%	10%	5%	10%	321
Financial literacy	Debt management	55%	70%	50%	50%	60%	60%	45%	55%	2,315
	General	45%	50%	70%	60%	35%	30%	45%	25%	2,210
	Risk management	35%	30%	40%	35%	35%	25%	10%	20%	1,343
Consumer protection	Credit information	5%	10%	5%	10%	5%	10%	5%	10%	321
	Market conduct	35%	30%	30%	60%	70%	80%	50%	85%	2,149

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

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

Seven key priorities

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

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

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

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

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

More efficient/lower cost remittances will have particular benefits for dependents, whose income is mainly derived from payments received from others. The dependents group has relatively low income, and reducing the costs of sending/receiving remittances could help to increase their disposable income.

As cash-based payments are gradually replaced by digital payments, information flows are generated, These can help to unlock access to credit, by providing information on individuals’ financial capacity. They will also help to improve the ability to levy taxes on businesses.

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

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

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

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

- Getting pilot MM projects up and running; refining models and moving to full-scale nationwide roll-out as quickly as possible
- Ensuring that agent networks function effectively, providing adequate liquidity for cash-out demands, and penetrate areas beyond the current reach of banks. Agents will need convenient facilities for rebalancing cash and e-value. MNOs should offer (as far as possible) an attractive business case to potential agents. The case for offering subsidies to agents in more remote areas in the early stages of MM development should be considered.
- Encouraging other banks and MNOs to consider MM products.
- Finalisation of the draft MM regulations to provide more certainty in the regulatory environment for MM service providers.
- In due course, promoting inter-operability between different MM platforms and between non-bank MM providers and banks.
- Facilitating cross-border MM (especially the Thailand-Laos channel).
- Ensure that high-level infrastructure (RTGS) is effective and functional, and that banks are required to participate.
- Establish clearing mechanism for interbank payments instruments (cheques, EFTs) with appropriate data communications channels.
- Consider national switch linking banks, retail terminals (POS), mobile companies etc., enabling payments functionality across channels (e.g. bank/mobile).
- Finalise the legal, regulatory and reporting framework for payments. The legal framework needs to be comprehensive, encompassing both core, high-value clearing and settlement systems, as well as retail payments service providers.
- Establish payments service providers association for discussion of issues of concern to the industry.

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

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

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

Action items.

- Banks need to be more innovative in extending distribution networks and in product design, moving beyond traditional products.
- Investigate the potential for branchless banking using independent agents.
- Regulatory barriers to the establishment of new branches by banks, MFIs and leasing companies – such as additional capital requirements - should be removed.
- Consider strategic alliances between banks and MFIs.

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

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

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

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

- BoL should take on regulatory and supervisory responsibility for the VF sector. This does not mean that BoL should directly supervise all VFs (an impossible task) but it should:
    - Establish a set of regulations, covering operating procedures, accounting and reporting requirements, cash management, risk management, provisioning etc., applicable to all VFs, perhaps graduated and related to size;
    - Take direct responsibility for supervising the larger VFs (with a balance sheet size above an agreed level);
    - Delegate supervisory responsibility for smaller VFs (the majority) to regional support organisations;
    - Develop regulations for VF support organisations and supervise them.
- Other requirements (for who?) include:
    - Utilise experience of GIZ-AFP project to roll out effective support and supervision mechanisms for VFs nationwide
    - Promote establishment of regional support organisations; or conversion of existing entities to more effective and properly structured support organisations
    - Third tier organisation for training, auditing
    - Consider Nanyobay Bank as provider of wholesale credit to successful VFs
    - Mobilise broad-based political support for the objective of stabilising the VF sector and undertaking reforms, committing resources to ensure sustainability and fulfilment of potential.

4. Improving the availability and sustainability of credit provision

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

Challenges. The credit market is distorted by regulatory restrictions (e.g. interest rate caps), and the provision of subsidised credit by government. Hence it is difficult for an effective credit market to develop. There is evidence of over-indebtedness amongst some groups of borrowers. Furthermore, many borrowers do not understand credit well, which can lead to the provision of credit on non-transparent and inappropriate terms and conditions. The range of available credit products is narrow, and there is a high reliance on collateralised credit.

Action items.

- Review the provision of subsidised credit by government with a view to reform that will help to reduce fiscal costs and improve credit discipline and impact effectiveness. Seek to learn from relevant international best practice.
- Review the impact of caps on interest rates on lending by financial institutions.
- Introduce rules on product information disclosure (e.g. APRs on credit and savings) and restrict credit institutions from using flat rate credit;
- Improve the effectiveness of credit information collection and sharing, by extending compulsory participation in and sharing of information with the credit information registry and requiring lenders to ascertain the credit record of borrowers before making new loans
- Development of new credit products especially those not dependent upon collateralised lending
- Require banks and other lenders to consider the ability of borrowers to service debt on the basis of income rather than simply considering collateral Tighten procedures relating to credit disbursement Improve credit sustainability by debt service

5. Developing accessible risk mitigation products

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

Challenges. Limited understanding of risks and risk management, especially insurance. Limited availability of products and distribution channels. Health-related risks and expenses are main concern for households.

Actions.

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

- Financial literacy for understanding of insurance and risk management.

6. **Promoting linkages between financial institutions and sectors**.

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

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

Actions.

- Build linkages between types of institutions, e.g. between banks and MFIs, and between banks (especially NBB) and village funds. These linkages could be of different kinds, including refinancing (provision of wholesale funds by banks to other financial service providers) and even client referrals.
- Remove regulatory restrictions on expansion of distribution networks, e.g. the capital requirement for new MFI branches.
- Remove regulatory restrictions on MFIs on raising capital from foreign sources.
- Equalise the regulatory requirements, e.g. regarding classification and provisioning for bad debts, and liquidity and capital adequacy requirements, across banks and MFIs
- Seek large investors (especially foreign) to invest in the MFI sector
- Encourage non-deposit-taking MFIs to grow and graduate into deposit-taking MFIs

7. **Consumer empowerment**

Benefits. Better understanding and improved ability of consumers to choose and use appropriate products; protection of consumers; reducing the dangers of over-indebtedness.

Challenges. There is a lack of understanding of financial concepts, products, and a low level of numeracy. Building understanding of financial issues is a long-term process. A broad range of interventions is needed, involving stakeholders beyond the financial sector. Channels for consumer redress are ineffective, as are restraints on market conduct / abuse. Access to information regarding financial institutions is limited, thereby undermining the ability of consumers to take well-informed decisions. There is also a need for a more consistent and transparent regulatory environment.

Action items.

- Aim to integrate learning on financial literacy into the education system;
- Encourage financial institutions to develop financial literacy amongst their customers;
- Extend depositor protection (deposit insurance) beyond banks to MFIs;
- Establish compulsory procedures in financial institutions for dealing with customer complaints;

- Introduce rules on product information disclosure (e.g. APRs on credit and savings) and restrict credit institutions from using flat rate credit;
- Require dormant bank account balances to be transferred to the BoL;
- Ensure that AML/CFT regulations is more effectively implemented, accompanied by appropriate tiered KYC regulations;
- Ensure that there is consistency in regulatory requirements across different but similar types of institutions, and consistency in interpretation of laws and regulations;
- Faster finalisation of draft laws and regulations, and ensuring that all existing laws, regulations guidelines and directives relating to the financial sector are publicly and readily available;
- Ensure that all financial institutions report publicly, consistently and in a timely manner that meets current legal requirements, and that all relevant financial sector statistics are regularly published.

Policy and regulatory imperatives

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

Cross-cutting initiatives

There are a number of cross cutting initiatives that can be undertaken to support financial inclusion, related to financial literacy, debt management and risk management, and credit information sharing. There is also a need for improved consumer protection.

Going forward

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

In this report MAP has identified seven priority areas that will provide the largest marginal gain in welfare through the extension of financial services. Addressing these areas will require a coordinated effort across institutions, product categories and market segments, in order to ensure that the underlying market inefficiencies are adequately addressed and the opportunities capitalised on. It will also require the government to work together with other stakeholders such as the private sector, development partners and sector experts. To assist these stakeholders to address the opportunities in harmony, a MAP Roadmap is being discussed by the MAP Steering Committee. The roadmap, with its imperatives detailed in Appendix 2, outlines in further detail the programme of action necessary to address the identified priority areas.

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