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FINANCE, COMPETITIVENESS, AND INNOVATION GLOBAL PRACTICE

Lao PDR

Access to Finance for Micro, Small, and Medium-Sized Enterprises in Lao PDR

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ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank	LCGC	Lao Credit Guarantee Sole Company
APR	annual percentage rate	MCAs	merchant cash advances
ASEAN	Association of Southeast Asian Nations	MFIs	microfinance institutions
B2B	business-to-business	MNO	Mobile Network Operator
BOL	Bank of the Lao PDR	MOIC	Ministry of Industry and Commerce
CIC	Credit Information Company	MSMEs	micro, small, and medium enterprises
CRB	Credit Reference Bureau	M&E	monitoring and evaluation
DFS	digital financial service	NBFI	Non-Bank Financial Institution
DTMFIs	deposit-taking MFIs	NDTMFIs	non-deposit-taking MFIs
FSAP	Financial Sector Assessment Program	NFIR	National Financial Inclusion Roadmap
FSP	financial service provider	NRA	National Revenue Authority
GDP	gross domestic product	PCG	partial credit guarantee scheme
GoL	government of Lao PDR	PFI	participating financial institution
GST	goods and services tax	POS	point-of-sale
G2B	government-to-business	P2P	peer-to-peer
IMF	International Monetary Fund	SME	small and medium enterprises
IFC	International Finance Corporation	UNICITRAL	United Nations Commission on International Trade Law
LAPNet	Lao National Payment Network Co Ltd		

I. EXECUTIVE SUMMARY

This technical note examines the state of access to and use of financial services for micro, small, and medium-sized enterprises (MSMEs) in Lao PDR. Based on extensive interviews with key private and public stakeholders, data collection efforts, and desk reviews of existing reports, laws, regulations, and policies, it provides an overview of the current status of financial inclusion for MSMEs and the enabling environment for MSME finance. This note also identifies key challenges and presents solutions with the potential to increase access to credit, including through alternative and innovative products. However, the report has limitations due to Lao PDR's lack of participation in a formal Financial Sector Assessment Program (FSAP), the limited availability and weak quality of data, and the lack of a unique definition of micro, small and medium-sized firms across the data sources used in the analysis.

MSMEs are vital to Lao PDR's economy, driving growth and employment, but detailed and timely data on these enterprises is lacking. They account for 99 percent of all firms and, akin to other countries in the region, provided 82 percent of jobs in 2018. Despite policies aimed at promoting formalization, such as simplifying the enterprise registration process, approximately 86 percent of Lao firms operated informally as of 2016. Issues with data precision on employment figures and GDP contribution by enterprise size persist, complicating efforts to integrate diverse data sources and accurately track MSMEs' GDP contribution. Recognizing the vital role of MSMEs in

economic development and poverty reduction, the government of Lao PDR (GoL) prioritizes them in its national strategies and strives to address their limited access to financial services. To advance this objective, authorities should adopt a simplified MSME definition that is broadly accepted by financial institutions. This definition should closely align with the characteristics of businesses most in need of support, facilitating effective data collection and making policy interventions more targeted and impactful. Prioritizing MSME development strategies is also crucial. Additionally, periodically collecting data on MSME economic activity and access to finance through existing or new surveys is essential for understanding key issues and informing adequate policies and support programs.

Access to finance is the main obstacle for MSMEs in Lao PDR. About 35.2 percent of registered companies cite access to finance as their primary barrier, nearly three times the regional average of 12.9 percent in East Asia Pacific. According to the World Bank Enterprise Survey, MSMEs in Lao PDR heavily rely on internal funds for 85 percent of their working capital expenses, while bank financing only accounts for less than 12 percent. Non-bank financial institution (NBFIs) credit finances less than five percent of working capital needs, and supply chain financing is negligible. Stringent collateral requirements, with collateral valued at 225.1 percent of the loan amount required on average, along with challenges such as complex application processes or unfavorable loan terms, further hinder financing. Additionally, demand-side obstacles, including irregular

income streams, low financial literacy, high informality within MSMEs, and unreliable financial management and reporting, also impede access to credit by undermining credit risk assessments.

MSMEs in Lao PDR have limited financial services available to them. Many financial institutions provide basic current account and credit services to MSMEs, but accessing broader financing options remains challenging. According to the Enterprise Survey, around 55 percent of MSMEs have a business-associated checking or saving account, while overdraft facilities are rare, with only one percent of small firms, 12 percent of medium-sized firms, and 16 percent of large companies having them. Additionally, 27 percent of firms had an active line of credit or outstanding loan. Notably, most large firms (80 percent) had a loan from a financial institution, with a notable disparity between small and large firms. Gender disparities in credit utilization are evident among small firms, particularly those owned by women, who are significantly less likely to have loans and, when they do, tend to have fewer loans compared to firms owned by men, suggesting possible gender barriers in credit markets.

The financial sector in Lao PDR is dominated by commercial banks, which have significantly grown their lending activities over time. Compared to other countries in the region, the penetration and outreach of the banking sector in Lao PDR is low, both in the number of commercial bank branches and ATMs, with modest growth over the years. Bank credit increased from 31 percent of GDP in 2012 to 60 percent of GDP by 2022. The surge between 2021 and 2022 was mainly driven by lending interventions during the COVID-19 epidemic and the impact of exchange rate depreciation. By the end of 2023, total credit from the banking sector represented an average of 50 percent of the system's total assets, with approximately 70 percent of loan portfolios denominated in foreign exchange (FX).

Despite considerable credit expansion, MSMEs in Lao PDR have not benefited from increased bank lending. Data from the Asian Development Bank (ADB) Asia SME Monitor reveals a concerning trend: the share of bank lending directed to MSMEs has steadily decreased from 30.9 percent of banks' total lending in 2015 to just 12 percent in 2022. This is significantly lower than in many other countries in East Asia Pacific for which comparable data is available, including Indonesia (21 percent), Malaysia (16.6 percent), and Thailand (21.2 percent). The decline in bank lending to the MSME sector coincides with an expansion of lending to the government as well as to the large private corporate sector. Additionally, MSME bank lending

has declined relative to the size of the economy, dropping from 12.7 percent of GDP in 2015 to 7.2 percent in 2022. Despite banks expressing commitment to innovation, their product offerings remain largely traditional and lack novelty. Primary credit facilities include investments and working capital loans, along with leasing options restricted to vehicles primarily used by individuals. Critical financial products like factoring, trade finance, movable assets-based loans, and overdraft facilities for MSMEs are notably absent. A key challenge is the limited capacity of banks to develop risk-based lending capabilities, which hampers their ability to offer tailored financial products that could support productive activities. This underscores the need for capacity building initiatives to enhance credit risk assessments, particularly for underserved and unbanked MSMEs.

While the involvement of NBFIs targeting MSMEs has been growing, it remains modest due to funding, regulatory and skills constraints. In terms of lending, the NBFi sector of Lao PDR is comparable to Indonesia's, representing around 3 percent of GDP. Microfinance institutions (MFIs), despite their focus on micro- and small enterprises, face significant limitations in scaling up their operations. Despite having a stronger rural presence compared to banks, MFIs' outreach remains restricted, impacting their scalability. Particularly, non-deposit-taking MFIs (NDTMFIs) struggle to access long-term funding in kip, primarily relying on internal resources due to limited external funding options, such as borrowing from competitors like banks. Additionally, the Lao National Payment Network Co Ltd (LAPNet), the main retail payments infrastructure in Lao PDR, is controlled by banks with a pricing structure favoring large transaction volumes. Ensuring fair and equal access to LAPNet for MFIs is crucial to promote interoperability for these institutions. The lack of digitization and innovation skills among MFIs further restricts MSMEs' access to finance, hindering the adoption of modern financial services and technologies. Regulatory constraints, such as substantially increased capital requirements, also impede MFIs from expanding their operations and extending credit to businesses. Authorities should consider reassessing capital requirements proportional to the risks of the MFI sector, contemplating higher loan sizes in the NBFIs segment needed by MSMEs, and reducing capital requirements for geographic expansion. To foster competition and help the MFI sector reach its potential, a potential approach involves transforming a portion of existing NBFIs into business lenders or attracting new nonbank lenders to enter this sector. Expanding wholesale funding schemes for qualifying providers, particularly MFIs, would enable them to offer cheaper and longer-term products

required in the market. Additionally, capacity building for both NBFIs and banks would empower them to effectively employ lending techniques necessary for expanding credit activities, especially in productive sectors of the economy. This initiative would also aid in enhancing outreach and presence for these providers.

Expansion of credit activities should be accompanied by innovation and the adoption of alternative credit products. In Lao PDR, traditional collateralized lines of credit remain the predominant financial products available for MSMEs. However, potential alternative financing solutions like accounts receivable finance, secured revolving lines of credit, crowdfunding, and leasing are largely inaccessible. Supporting the development of these products necessitates the introduction of a legal and regulatory framework to facilitate their growth, enhance the operations of the credit registry, and improve the enforcement of creditors' rights. This framework could involve establishing a clear definition and basic contract law provisions to support accounts receivable finance or implementing regulations for peer-to-peer lending and investment-based crowdfunding services. Additionally, measures could be introduced to enhance the viability of these financial products, such as implementing an electronic invoice system to improve the reliability of invoices for discounting and reduce financial asymmetry for businesses. Moreover, regulations on maximum payment terms for government-to-business (G2B) and business-to-business (B2B) payments to MSMEs could be introduced.

The credit reporting system requires significant upgrades, and to develop a client orientation for market responsive value-added services with relevant re-pricing. Since 2012, the BoL has operated a credit registry. In December 2019, the Credit Information Company (CIC) was spun-off from BoL's IT Department. The CIC has achieved significant participation from the entire financial industry, particularly NBFIs. However, the quality of its offerings remains hindered by the low capacity of member banks and NBFIs, notably struggling to seamlessly feed information to the CIC and limited alternative data sources such as utility payments (beyond electricity), mobile phone usage, and trade credit records. There are significant reporting and capacity gaps in the CIC, hindering large coverage of registered enterprises and the adult population, as well as robust lookup functionalities. Expanding the CIC's service offerings and their quality, including the provision of value-added services such as deeper MSME information and credit scoring, could enhance credit information and financial sector supervision, thereby supporting greater access to finance.

The secured transactions system for movable assets, despite recent reforms, lacks specific rules critical for collateral enforcement. Although Civil Code No. 55/NA, effective since May 2020, provides clarity on the creation of security interests and perfection procedures, it lacks specific rules regarding contractual limitations, treatment of rights between judgment and secured creditors, enforcement of security rights, and rules regarding cross-border guarantees. This ambiguity results in inconsistent enforceability of credit agreements, undervaluing collateral, and complicating seizure procedures. Secured creditors have limited formalized out-of-court enforcement options, hindering collateral recovery. Established in 2013 with assistance from the International Finance Corporation (IFC) and managed by the Ministry of Finance, the movable collateral registry was upgraded in 2020 with registration fee funding. While utilized by over 30 companies, mainly banks and leasing firms, its use among MFIs is sporadic. Challenges include a flat registration fee discouraging common asset registration, predominantly vehicles, and doubts among leasing firms about its efficacy in asset repossession. To address these challenges, authorities should consider issuing a comprehensive set of rules that adequately deal with all aspects of modern secured transactions, in line with international best practices and the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Secured Transactions (2016), which exhaustively deals with security interests in all types of tangible and intangible movable property. Moreover, to increase usage of the movable collateral registry, it is recommended to introduce a tailored fee structure based on asset value and launch targeted awareness efforts aimed at banks and MFIs to promote movable asset registration benefits and enhance their capacity to utilize the new system. Additionally, expanding mediation and arbitration services would provide viable alternatives to lengthy court proceedings, enhancing creditors' options for dispute resolution. It also recommended to conduct a targeted awareness campaign for MSMEs on the new bankruptcy law which remains largely unused, as well as training for the private and financial sectors on negotiating restructurings through the new regime.

The GoL heavily relies on subsidization in MSME lending, prioritizing low-interest rates to bolster competitiveness. It predominantly relies on wholesale lending facilities, with two government-funded schemes administered by the BoL and the Ministry of Industry and Commerce, alongside two donor-supported schemes. While donor-funded MSME credit schemes operate on market principles, the government-funded programs prioritize concessional financing, which can hinder providers' profitability and access to funds due to existing interest

rate caps and disbursement delays. Authorities should consider limiting concessional finance-based programs and transitioning all existing support schemes to an independent fund managed by a new apex organization to enhance governance in line with international best practices. This would provide access to funding, particularly for capital-starved MFIs and other NBFIs, that meet sound due diligence criteria set by the apex organization. Additionally, there is a lack of outcome tracking for borrowing MSMEs, highlighting the necessity for robust monitoring and evaluation (M&E) systems. Longitudinal surveys are essential to gather lessons learned and track the impact of support programs over time. While technical assistance is provided to partnering financial institutions under the current government support programs, MSMEs often receive inadequate capacity-building support crucial for improving their creditworthiness and bankability. Addressing this gap is essential to ensure the effectiveness and sustainability of financial support programs for MSMEs.

Carefully crafted and well-governed risk-sharing mechanisms, such as partial credit guarantee schemes, are still lacking and should be prioritized to encourage financiers to undertake more risk and crowd in private capital. Under the World Bank-financed MSME project, the government plans to establish a state-owned and licensed partial credit guarantee scheme (PCG). The Ministry of Finance has formally approved the establishment of the Lao Credit Guarantee Sole Company (LCGC). The proposed entity has been meticulously designed to ensure sound corporate governance, professional management, and transparent guarantee decisions based solely on commercial principles, in line with international best practices. A well-managed PCG scheme has the potential to enhance access to finance for MSMEs unable to secure loans due to insufficient collateral, while also mobilizing private capital by incentivizing banks to extend

credit to MSMEs. It is crucial that authorities expedite the legal establishment and operationalization of the LCGC to incentivize formal credit to underserved segments such as MSMEs and agriculture. A carefully crafted and well-governed scheme would facilitate effective risk management of the portfolio, contributing to the overall stability and growth of the MSME sector.

Coordination of reform efforts among public sector stakeholders and cooperation between public and private institutions will be critical for the successful increase of access to finance for MSMEs. This hinges on establishing a robust foundation of comprehensive and regular MSMEs data, employing simple and standardized definitions universally. Public institutions such as the Ministry of Finance, BoL, and agencies like the SME promotion and Development Office should prioritize longitudinal data collection on MSMEs, utilizing a standardized definition framework, implemented by all stakeholders. This entails evaluating the effectiveness and impact of government programs on supported MSMEs in terms of revenues, tax collection and employment, compared to suitable control groups. Such data would guide policy makers in making necessary adjustments and ensuring maximum effectiveness of government support programs in promoting access to finance. Equipping public institutions to carry out these actions and fostering dialogue and cooperation between public and private entities, including banks, NBFIs, mobile network operators, and fintech companies, would enhance the likelihood of achieving positive outcomes.

Table 1 presents actionable recommendations designed to enhance access to finance. These recommendations are grounded in best practices and are customized to address the specific conditions in the Lao PDR market. Priority should be given to recommendations identified as having high potential impact in the short to medium term.

TABLE 1: Recommendations

RECOMMENDATION	TIMEFRAME	IMPACT	RELEVANT ENTITIES
<i>SME finance data for expansion of access to finance</i>			
Simplify MSME tiers (micro, small, medium) definitions to ensure consistency across all stakeholders and adherence by financial institutions	ST	H	MoIC, BoL
Collect periodic data on enterprise economic activity and access to finance, as part of existing or new statistical surveys	MT	M	MoIC, MoF, LSB, BoL
<i>Financial products. Providers, and enabling policies</i>			
Consider capacity building support aimed at enhancing MSME lending capacity and product development, particularly tailored for women entrepreneurs. This could include technical assistance to develop credit products that bypass traditional collateral and instead leverage alternative information sources, such as business cash-flows.	ST	M	BoL, MoF

TABLE 1, continued

RECOMMENDATION	TIMEFRAME	IMPACT	RELEVANT ENTITIES
Introduce definitions of factoring and basic default right of parties into the legal framework	MT	M	MoF
Review the Goods and Services Tax (GST) Act and introduce the definition of an e-invoice; introduce "clearance" real-time e-invoicing GST system	LT	M	NRA
Consider introducing regulations on maximum payment terms for Government to Business (G2B) and business-to-business (B2B) payments to MSMEs	MT	M	MoF
Provide a clear regulatory framework for peer-to-peer (P2P) lending and investment-based crowdfunding	MT	M	SEC, BoL
Review and adjust current capital requirements for (microfinance institutions) MFIs to better align with sector risks, including accommodating larger loan sizes in the non-bank financial institutions (NBFIs) segment for MSMEs. Explore options to reduce capital requirements for geographic expansion initiatives by NBFIs.	ST	H	BoL
Direct access to Lao National Payment Network Co Ltd (LAPNet) should be granted on fair and open basis, including to NBFIs	MT	M	BoL
Strengthening credit infrastructure			
Modernize the Credit Information Company (CIC) to enhance its capabilities, enabling timely updates, and enhancing the quality and range of its services	ST	H	CIC
Introduce a tiered pricing strategy for corporate and individual credit reporting data. Engage financial service providers to offer additional value-added MSME services tailored to market needs, with pricing reflecting the added value provided	MT	M	CIC
Broaden the scope of data within the credit registry to encompass supplementary alternative information sources	MT	M	BoL
Review and update the Credit Reference Act of 2011 to align with current best practices in credit reporting	MT	M	BoL
Issue a set of rules that deals with all aspects of modern secured transactions, in line with international best practices and the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Secured Transactions	MT	M	MoJ
Support the online collateral registry rollout through a tailored fee structure based on asset value, and targeted market awareness efforts aimed at banks and MFIs to promote movable asset registration benefits.	MT	M	BoL
Expand the availability of mediation and arbitration services through institutions like the Center for Economic Dispute Resolution and private economic dispute resolution offices to provide creditors with viable alternatives to lengthy court proceedings	MT	M	MoJ
Conduct a targeted awareness campaign for MSMEs on the new bankruptcy law which remains largely unutilized, as well as training for the private and financial sectors on negotiating restructurings through the new regime	MT	M	MoJ
Improve the efficiency of government support programs			
Implement rigorous Monitoring and Evaluation (M&E) mechanisms for governmental MSME lending initiatives to ensure that public expenditure aligns with the growth priorities of Lao PDR, effectively measuring and verifying their intended impact	ST	M	BoL, MoF, MOIC
Accelerate the legal establishment of the Lao Credit Guarantee Fund (LCGC); appoint the LCGC Managing Board Director and CEO/Director; and prepare LCGC operating policies, rules, and instruments, to incentivize formal credit to underserved segments, including MSMEs and agriculture,	ST	H	MoF, BoL, MOIC
Increase wholesale funding schemes for eligible providers, particularly capital-starved MFIs. Phase out concessional finance-based programs and transition governmental MSME lending initiatives to an independent fund managed by a new APEX organization to improve governance aligned with international best practices	MT	H	MoF, BoL, MOIC
Scale up capacity-building support to MSMEs, in particular for women entrepreneurs, which is essential for improving their creditworthiness and bankability	MT	M	BoL, MoF, MOIC

Source: World Bank.

Timeframes: ST = short-term, 12 months; MT = medium-term, 1 to 3 years; LT = long-term, more than 3 years. Impact: H = High, M = Medium, L = Low. MoF = Ministry of Finance; MoJ = Ministry of Justice; NRA = National Revenue Authority.

II. INTRODUCTION

This technical note delves into the accessibility and utilization of financial services for micro, small and medium-sized enterprises (MSMEs) in Lao PDR. The findings and recommendations stem from stakeholder interviews and thorough desk research encompassing available data, reports, laws, and regulations. The note aims to present an overview of the current state of financial inclusion for MSMEs and the corresponding supportive environment for MSME finance. It focuses on assessing the supply side and the availability of suitable finance to meet MSME funding needs, identifying any barriers to the development of more robust and diverse offerings. To provide a comprehensive understanding, the note evaluates the array of financing options available, the adequacy of financial infrastructure, the emergence of digital financial services, as well as public and private sector policy interventions and their commitment to the MSME finance agenda.

III. MACROECONOMIC AND FINANCIAL SECTOR CONTEXT

After a decade of rapid economic growth, the Lao economy's growth remains below 2019 levels, with a weak outlook due to protracted macroeconomic instability. Growth was spurred by externally financed capital investment (in hydro, mining), which has contributed to soaring debt levels. Lao is now in debt distress (2023 Debt Sustainability Analysis) and is experiencing sharp external imbalances and limited foreign exchange, which in turn have contributed to rapid depreciation of the Lao Kip (31 percent in 2023 and over 136 percent from 2019 to March 2024), and high levels of inflation (31 percent in 2023) due in part to high import dependence. The economic outlook is uncertain amid structural imbalances associated with limited foreign reserves, high public debt, and a high import bill, which will continue to put pressure on the kip and thus inflation.

The bank-dominated financial sector is highly vulnerable to deteriorating macroeconomic conditions, with a high degree of dollarization, FX liquidity constraints, rapid currency depreciation, and record inflation, while the top banks generally have lower capital buffers than smaller banks. The largest state-owned commercial bank, holding 34 percent of system assets, faces declining capital adequacy ratios below prudential minimums. Asset quality data and evergreening may understate the impact of the prolonged regulatory forbearance measures (as well

as evergreening and misreporting/weak accounting standards), potentially resulting in a substantial increase in NPLs after the phasing out of the measures, and sector profitability is hampered by negative real interest rates. The sector is significantly exposed to the public sector through bond purchases and lending to state-owned enterprises, while the government's weak fiscal position limits its capacity to inject capital.

Government policy responses to the country's macroeconomic challenges have negatively impacted the bank-dominated financial sector. In particular, banks (mainly BCEL) are bearing a growing portion of the deficit financing burden through bond purchases and issuance of triangle bonds to resolve expenditure arrears. Given restrictions to access to international capital markets, the 2023 International Monetary Fund (IMF) Article IV (debt sustainability analysis) estimates that domestic debt would grow from 12 percent of GDP in 2023 to 30 percent of GDP by 2037, as domestic banks are assumed to cover a significant portion of government financing needs. This would threaten to crowd out private sector financing, and also hurt profitability, given that government bond yields are extremely low (6-8%).¹ At end of 2023, BCEL already holds close to half of government issued securities, while its loan/deposit ratio has declined from 75 percent in 2019 to 49 percent in 2023. Government has issued "triangle" bonds to banks to fulfill expenditure arrears to government contractors with bank loans, but the interest rates are usually lower than original loan, resulting in a financial loss for the commercial banks. The structure of the banking sector is also not conducive for expanding access to finance for SMEs. State-owned banks and recently privatized banks have inherent cost advantages in capturing low-cost deposits from public employees yet dedicate only small portions of lending portfolio to MSMEs. Other banks that are actively trying to build SME portfolios struggle to compete for market share given cost disadvantages.

The agenda for addressing financial sector vulnerabilities, and creating a more favorable climate for SME finance, begins with addressing macroeconomic issues that have impacted the sector (the World Bank, Lao Economic Monitor, May 2024, covers this under "The Vital 5: Reforms to Secure Macroeconomic Stability in the Lao PDR). In the meantime, authorities need to strengthen the financial safety net in several areas. First, authorities need to carefully manage the phase-out of regulatory forbearance measures, which could see capital levels fall below prudential minimum in several banks. Authorities could use the prompt and corrective action (PCA) framework

1. <http://www.lsx.com.la/market/bond/list.do>

to manage vulnerable banks in a responsible manner, by developing credible plans to restore capital adequacy over time. PCA and resolution regulations remain untested and lack detailed implementation guidelines necessary for authorities to act quickly to stem a banking crisis. Authorities should also develop emergency liquidity provision (ELA) framework, which is necessary to provide emergency liquidity on a short notice. The untested deposit protection scheme needs further strengthening to ensure its readiness to handle a bank failure. Finally, as the overall regulatory and bank restructuring framework improves, authorities must establish credibility by enforcing its regulatory powers provided under the revised Commercial Banking Law (2023).

This context presents a challenging environment for expanding access to finance for MSMEs and underscores the importance of efforts to bring about macroeconomic stability as a precursor for healthy financial sector development (a separate report will analyze the role of the state and financial sector vulnerabilities). However, despite these challenges, Lao PDR has the opportunity to take actions that would significantly improve the environment for MSME finance by supporting the development of innovative products (credit guarantee, digital, factoring among others), strengthening credit infrastructure, removing regulatory obstacles and leveling the playing field, and more effectively utilizing limited public resources.

IV. MSMEs: OVERVIEW OF ECONOMIC AND FINANCIAL CONDITIONS

A. DEFINING MSMEs

Globally, defining MSMEs poses a challenge due to the absence of a single universal definition recognized by national authorities or international organizations. Nevertheless, the government of Lao PDR has made efforts to tackle this issue by establishing the legal classification of MSMEs in 2011 under the SME Law, updated via the Decree No.04/GOL/2023. As shown in Table 2, this classification categorizes firms based on three indicators: the number of workers, annual turnover, or total assets, with thresholds varying by manufacturing, trade, and services industry.

However, the legal classification of MSMEs poses challenges beyond complexity hindering its beneficial adoption in the financial sector. Since only one indicator is required for classification, the count of MSMEs can vary significantly depending on the chosen criterion (OECD/ERIA, 2018). This variability complicates the assessment of creditworthiness and risks for financial institutions, hindering their ability to accurately categorize businesses and tailor their financial products and services. Consequently, commercial banks and other financial institutions often employ differing classifications for loan segments, with loan amount and turnover being common metrics. Total assets and number of employees are sometimes also used

TABLE 2: MSME Definition

SECTOR	ITEM	MICRO	SMALL	MEDIUM
Manufacturing	Annual average number of employees	1–5	6–50	51–99
	Total assets (KIP)	Not exceed 120,000,000	Not exceed 1,200,000,000	Not exceed 4,800,000,000
	Annual turnover (KIP)	Not exceed 400,000,000	Not exceed 3,000,000,000	Not exceed 6,000,000,000
Trade	Annual average number of employees	1–5	6–50	51–99
	Total assets (KIP)	Not exceed 180,000,000	Not exceed 1,200,000,000	Not exceed 4,800,000,000
	Annual turnover (KIP)	Not exceed 400,000,000	Not exceed 4,500,000,000	Not exceed 9,000,000,000
Services	Annual average number of employees	1–5	6–50	51–99
	Total assets (KIP)	Not exceed 240,000,000	Not exceed 1,800,000,000	Not exceed 7,200,000,000
	Annual turnover (KIP)	Not exceed 400,000,000	Not exceed 2,250,000,000	Not exceed 6,000,000,000

Source: ADB Asia SME Monitor 2023 database. Data from Decree No.04/GOL/2023 on MSME classification (enacted on 12 January 2023).

Notes: MSME stands for micro, small, and medium-sized enterprise. According to Article 10 of the MSME Law, firms that produce commercial goods, including those in the areas of handicraft, agriculture, processing industry, and commercial goods are classified under manufacturing. Trade encompasses all firms engaged in wholesale and retail trade activities. Services include all firms that operate any type of service, such as tourism, transportation, banking and finance, education, and health (Lao PDR SME Law, 2011).

to differentiate MSMEs. Commercial banks do not report on MSME portfolios to the Bank of the Lao PDR (BOL), and do not appear to practice segmentation of MSME loans. Despite the different characteristics of microenterprises versus small and medium sized enterprises, these tend to be lumped together.

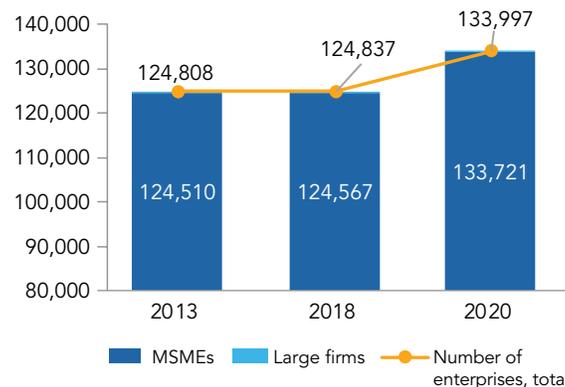
The lack of data from the financial sector and the government significantly restricts the analysis of the state of MSMEs in Lao PDR. A simplified official, updated definition would be helpful to deploy to better understand the levels of MSME access to finance being provided by financial institutions. This simplified definition should align closely with the characteristics of businesses that require the most support, facilitating efficient data collection and analysis. With the establishment of uniform definitions of MSME segments, disaggregated data could be collected from supervised financial institutions, as well as on the state of enterprises in Lao PDR writ large. Such an exercise would facilitate a greater understanding of which types of MSMEs are being served by private and public sector services, as well as the corresponding gaps in coverage of MSME segments. This information could help identify MSME sectors with growth opportunities for prioritization, and tailored instruments could be designed and deployed to address the financing needs of MSMEs at different stages of development. Additionally, prioritizing policy and private sector action through better targeting and measurement of progress of outreach to specific MSME segments would be enabled. The planned baseline survey for MSME access to finance being undertaken by Ministry of Industry and Commerce (MOIC) with World Bank support is an opportunity to gather such data and further explore MSME finance.²

The report classifies firms by their number of workers into micro (less than 5 workers), small (5 to 19 workers), medium (20 to 99 workers), and large (100 or more workers).³ However, in tables and figures drawn from data reported by the Lao PDR government, MSMEs are defined based on the criteria summarized in Table 2.

B. IMPORTANCE OF MSMEs IN LAOS

The latest Economic Census reveals a 7 percent increase in Lao PDR's enterprises from 2018-2020, totaling 133,997 firms, predominantly micro, small and medium-sized (MSMEs). Large enterprises represent less than 1 percent (Figure 1).⁴ As of 2016, approximately 86 percent of Lao

FIGURE 1: Number of enterprises by size



Source: ADB Asia SME Monitor 2023 database. Data from the Ministry of Industry and Commerce of Lao PDR.

firms operated informally without a proper business registration.⁵ MSMEs dominate employment, providing 82 percent of jobs in 2018, akin to Thailand and other countries in the region (Panels A and B of Figure 2).⁶

However, despite policies that have promoted formalization of the MSME sector, the high prevalence of informal jobs in the country remains a challenge for regulators.⁷ According to data published by the International Labor Organization (ILO), total informal employment in 2022 –which includes jobs created in households, informal or formal firms– accounts for 90.4 percent of total employment. Informal employment is higher among women than men (91.6 vs 89.5 percent), and particularly high in the agricultural sector, where 98 percent of agricultural workers are informal. Job informality has shown little improvement over time, with the share of informal employment being slightly lower (i.e., 88.3 percent) in 2017. However, challenges persist in data precision on employment figures and GDP contribution by enterprise size, highlighting the difficulty in integrating data from diverse sources,⁸

2. This survey is part of the MSME Access to Finance – Emergency Support and Recovery Project.

3. This MSME classification has been chosen due to data availability, as most data in this report are derived from the World Bank Enterprise Survey, which uses this specific definition.

4. The legal definition of MSMEs in Lao PDR is displayed in Table 1 of Appendix A.

5. The 2016 Small and Medium Enterprises Development Plan, formulated by the Department of SME Promotion (DOSMEP), estimates that 86% of all firms in the country are microenterprises or family businesses that operate informally (OECD 2018).

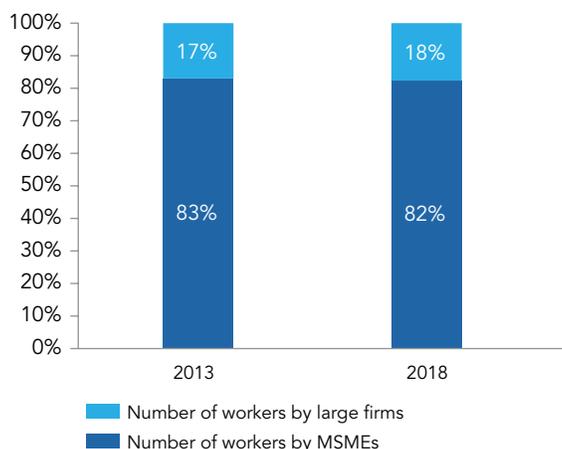
6. One caveat when comparing employment of MSMEs across countries in the region is MSME classifications refer to individual national definitions, with some countries (e.g., Malaysia, Viet Nam), excluding agriculture.

7. The simplification of the enterprise registration process and the growing necessity to state a TIN (Tax Identification Number) for administrative processes have proved successful in the formalization of the MSME sector. However, as ILO data suggests, MSME formalization has not been followed by an increased formalization of workers.

8. For instance, the 2017 Labour Force Survey accounts for 724,000 non-civil service, non-agricultural employment, to be compared with the 574,000 enterprise employment reported as of 2018 in the ADB monitor. The inclusion or exclusion of informal employment does not explain the discrepancy.

FIGURE 2: MSME's contribution to employment

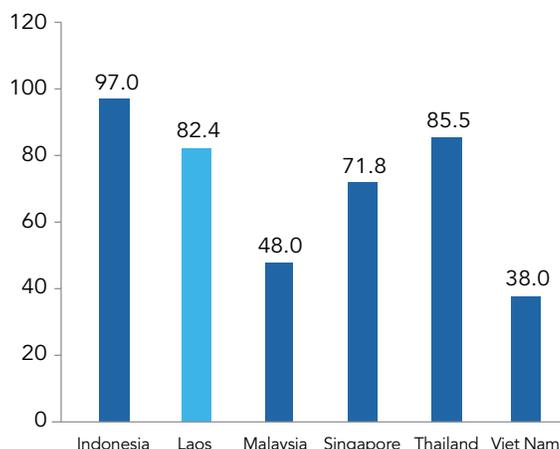
A. Contribution of firms to employment in Lao PDR (by firm size)



Source: ADB Asia SME Monitor 2023 database. Data from the Ministry of Industry and Commerce of Lao PDR.

Notes: Panel A plots the share of employment by firm size in Lao PDR. Panel B plots the share of workers employed by MSMEs in 2018, the most recent year with information for Laos.

B. Contribution to employment of MSMEs in 2018 (regional comparison)



Source: ADB Asia SME Monitor 2023 database.

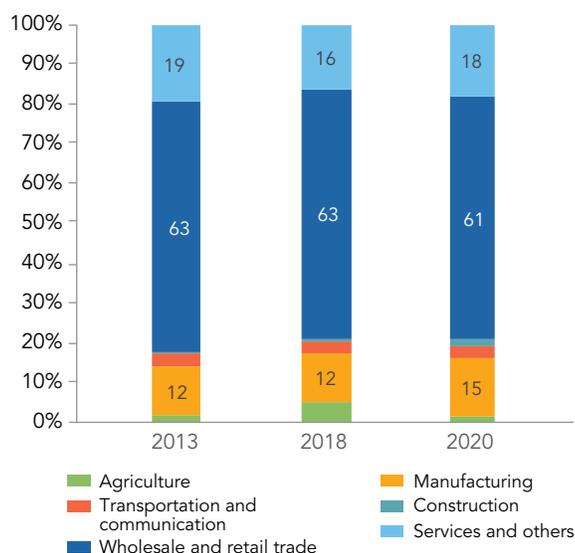
and tracking MSME's GDP contribution as well as missing data issues. Notably, half of the 2017 ILO-MPI Labour Force Survey records lack reported sizes⁹ and MoIC lacks employee numbers.

C. CHARACTERISTICS OF MSMEs IN LAOS

Over time, MSME distribution across sectors has remained stable, with the majority in trade, services, and manufacturing industries (Figure 3). In 2020, trade comprised 61 percent of MSMEs, while services and manufacturing sectors constituted 18 and 15 percent of firms, respectively.

Information to characterize and study the multiple types of firms comprising the MSME sector in Lao PDR is scarce. Data from the 2018 World Bank Enterprise Survey sheds light on the characteristics of firms with 5 or more employees that belong to the non-agricultural, formal private sector of Lao PDR.¹⁰ Based on this restricted universe of firms, the survey reveals that 76 percent of firms are classified as small, 20.7 percent as medium, and only 3.3 percent as large.¹¹ Small firms employ on average 7 workers and earn 3,580 million KIP annually.

FIGURE 3: Sectoral distribution of MSMEs



Source: ADB Asia SME Monitor 2023 database. Data from the Ministry of Industry and Commerce of Lao PDR.

9. See footnote #2 on page 3 of "Understanding informality and expanding social security coverage in Lao People's Democratic Republic: A quantitative study of the labour force and enterprise landscape", ILO, January 2003

10. Appendix A summarizes the characteristics of informal sector firms and agricultural entrepreneurs of Lao PDR, relying on the 2019 Lao PDR Informal Sector Business Survey (ISBS) as well as the 2017 and 2021 Global Findex Surveys.

11. The Enterprise Survey classifies firms by their number of workers into small (5 to 19 workers), medium (20 to 99 workers), and large (100 or more workers). Firms with less than 5 workers are excluded from the sample. Also excluded from the sample are informal firms that are not registered with the government. However, the 2019 Informal Sector Business Survey Dataset is analyzed in this note to complement the Enterprise Survey indicators.

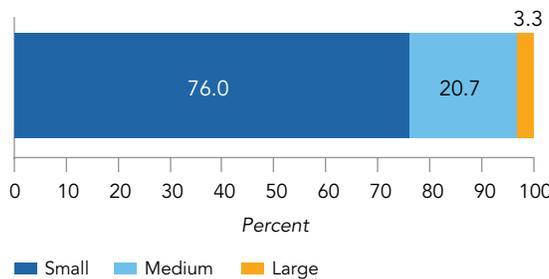
Medium-sized firms have on average 42 workers and annual revenues of 15,090 million KIP. Large companies on average have 157 employees and 23,940 million KIP (Panels A and B of Figure 6).

In the formal sector, male ownership predominates, with female ownership rare among larger firms. Nationally, 36 percent of private-sector firms are fully or partially owned by a woman. Only 8 to 9 percent of medium and large-sized companies are female-owned. In contrast, 45 per-

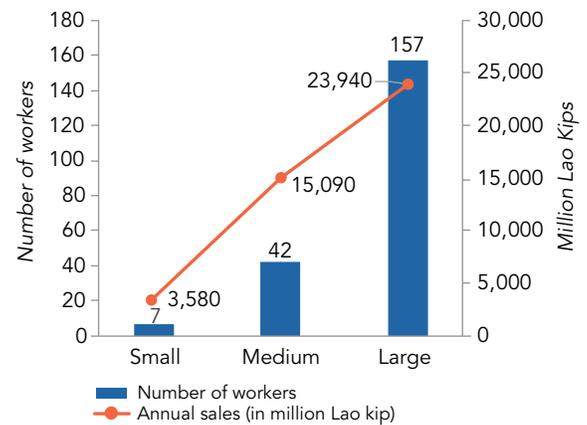
cent of small firms are female-owned. Another way to analyze gender differences in firm ownership is by comparing the distribution of firms owned by men vs. women. Women are substantially more likely to own small firms – 94.6 percent of female-owned firms are classified as small. Only 5.4 percent of female entrepreneurs own a private firm that employs 20 or more workers, with 0.8 percent of these firms having 100 or more workers. In contrast, 65 percent of firms owned by men are small, 30 percent are medium, and about 5 percent are large.

FIGURE 4: Size of formal firms in Lao PDR.

A. Distribution of firms by size



B. Average workers and annual sales last fiscal year by firm size.

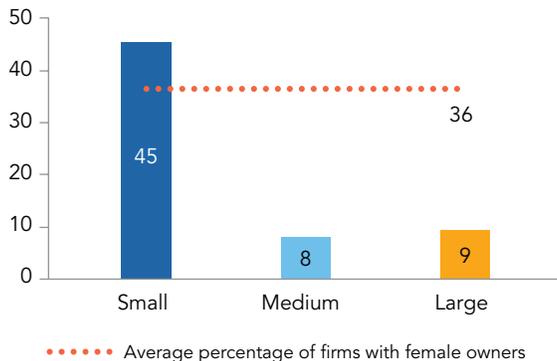


Source: Laos Enterprise Survey 2018 database.

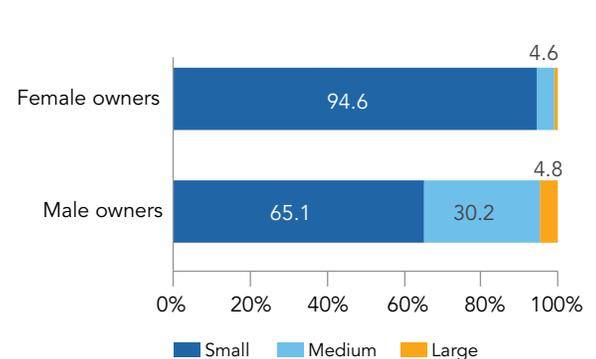
Notes: Panel A plots the distribution of firms by size. Panel B plots the average number of workers and annual sales (reported in million Lao kips) of small, medium and large firms in 2018. The data is representative of the universe of non-agricultural registered small, medium and large private-sector firms in Lao PDR. Micro firms (firms with less than 5 workers) are excluded from the sample.

FIGURE 5: Gender of owner

A. Share of firms with female owner



B. Distribution of firm size by female vs. male ownership



Source: Laos Enterprise Survey 2018 database.

Notes: Panel A of the figure plots the percentage of firms with female owners. Percentages are displayed for all firms (red dotted line) and for each size category. Panel B plots the distribution of firm size by female vs. male ownership.

D. MSME ACCESS TO CREDIT PRODUCTS

Data from the 2018 World Bank Enterprise Survey provides valuable insights into the financial situation and constraints faced by firms in Lao PDR. Representative of the universe of non-agricultural registered private-sector firms in the country, this data offers a detailed look at the characteristics of average enterprises as well as differences among small, medium, and large companies.¹²

Access to finance stands out as the primary obstacle for small and medium-sized firms, with 35.2 percent of registered companies citing it as their main barrier (Figure 6). The Enterprise Survey elicits inputs from owners or top managers, revealing various hindrances such as inadequate physical infrastructure, such as transport connectivity to markets or access to a reliable electricity supply, as well

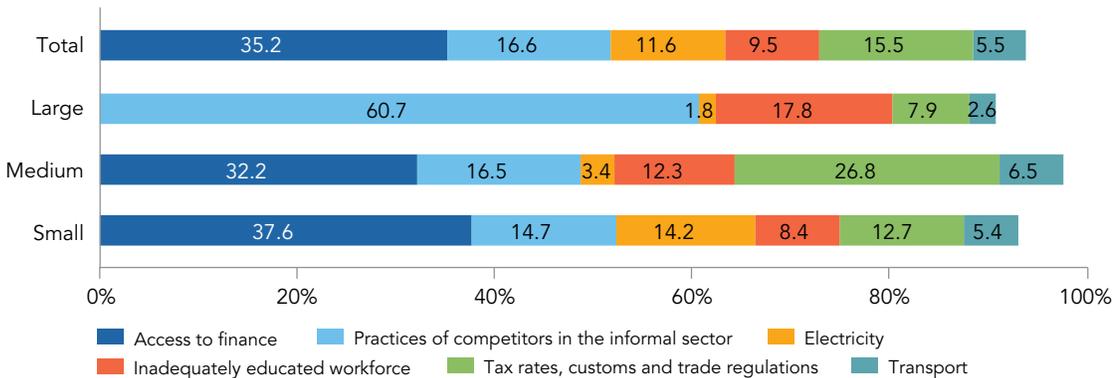
as challenges like inadequately educated workforce, weak economic governance (e.g., in areas such as trade regulations, business licensing, taxation, customs procedures), and unfair competition from firms in the informal sector. Notably, perceptions vary between SMEs and large enterprises, with the latter identifying different challenges such as informal sector competition, workforce education, and regulatory or high tax concerns as more pressing issues.

Access to Credit Products by Formal MSMEs

The Enterprise Survey underscores the reliance of small and medium firms in Lao PDR on internal funds to finance their working capital requirements. On average, these firms utilize internal funds for 85 percent of their short-term expenses, with bank financing accounting for less than 12 percent. NBF credit plays a minor role, financing less than five percent of working capital needs, while supply chain financing, using loans from suppliers or customers, is negligible, accounting for less than one percent of short-term working capital needs.

12. The Enterprise Survey classifies firms by their number of workers into small (5 to 19 workers), medium (20 to 99 workers), and large (100 or more workers).

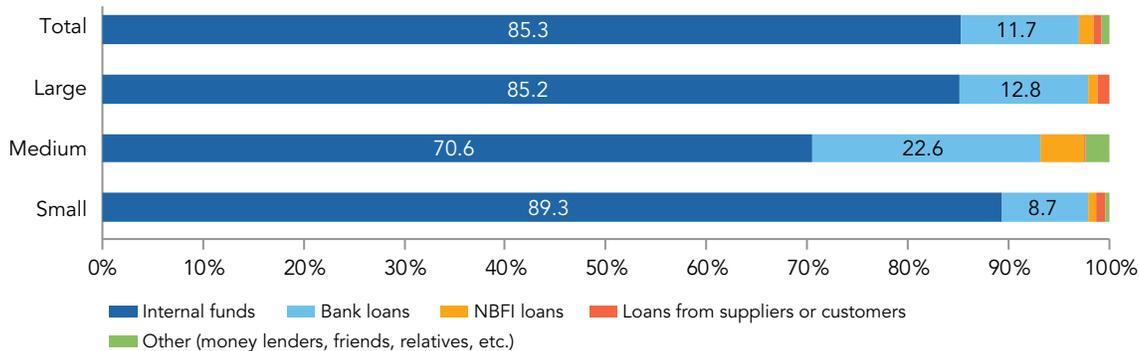
FIGURE 6: Biggest obstacle for the establishment



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the share of firms by the biggest obstacle they reported facing. Shares are displayed for all firms and for each size category.

FIGURE 7: Financing of working capital



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of working capital (in the fiscal year prior to the survey) that was financed from each source. Percentages are displayed for all firms and for each firm size category.

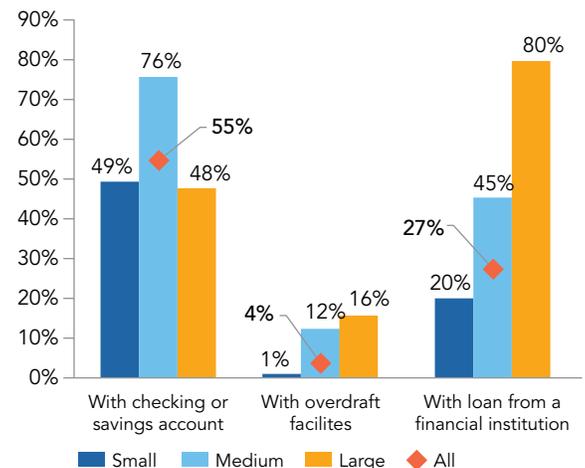
In terms of financing of fixed assets, smaller firms exhibit a greater dependence on internal funds for their medium and long-term expenditures. The Enterprise Survey also provides insights into the financing sources for SME's acquisition of fixed assets, such as buildings, land, machinery, and equipment. Firms with fewer than 20 workers internally finance 94 percent of their fixed assets, with only 5.2 percent sourced from bank credit. Medium-sized firms rely more on formal financing, but 75.4 percent of their medium- and long-term expenses are still internally funded through retained earnings. Large firms, however, rely significantly on bank credit, which finances 49.8 percent of their fixed assets, followed by 42.3 percent from internal funds and 7.9 percent from contributions by owners.¹³ This overall reliance on internal funds suggest inefficiencies in financial intermediation, possibly limiting firms to internally financed projects.

According to the Enterprise Survey,¹⁴ approximately 55 percent of SMEs have a checking or saving account associated with their business. Overdraft facilities, allowing clients to withdraw money from financial institutions, are less common, with only one percent of small firms, 12

percent of medium-sized firms and 16 percent of large companies having them. 27 percent of firms had an active line of credit or an outstanding loan from a financial institution at the time of the survey. Notably, most large firms (80 percent) had a loan from a financial institution, while the majority of small firms (80 percent) did not. Medium-sized firms reported having active credit at a rate of 45 percent.

Even among the firms with outstanding loans, the majority tend to have only one credit, with 17.8 percent of firms have two loans and 4.1 percent have three or more. This trend persists even for large firms with 100 or more employees, as 88.7 percent of them with credit possess only one active loan with a financial institution.

FIGURE 8: Financial products of firms

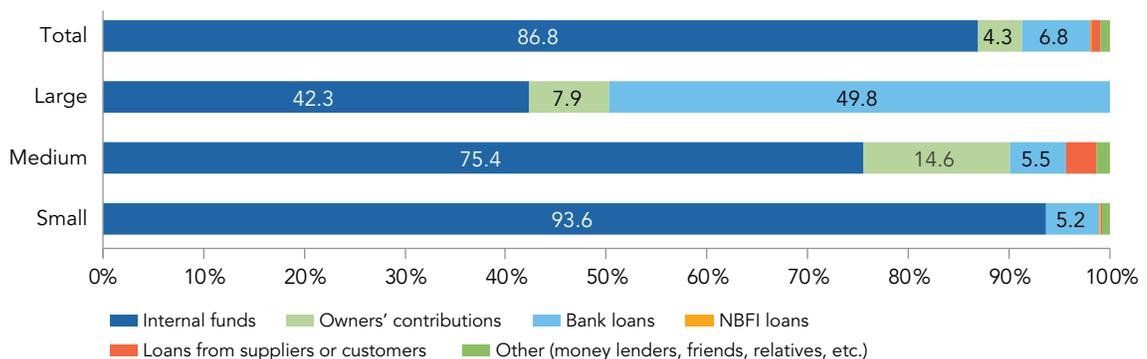


Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms (all firms and by size category) with a checking and/or saving account, that have an overdraft facility, and that have an open line of credit or an outstanding loan from a financial institution.

13. It's important to note that the data was collected in 2018, before the significant expansion of leasing companies in the country, which typically facilitate the purchase of vehicles, machines, and equipment. Subsequent firm-level data from recent years would provide insight into whether the expanded credit of leasing companies is aiding firms in financing their operations more efficiently.
14. The ES collects three indicators that proxy for the use of financial products and services by private-sector firms: the percentage of firms with a checking or savings account, the percentage of firms with overdraft facilities, and the percentage of firms with a loan from a financial institution. These indicators measure the extent to which Firms use basic products offered by financial institutions to finance projects and manage their cashflows and payments.

FIGURE 9: Financing of fixed assets



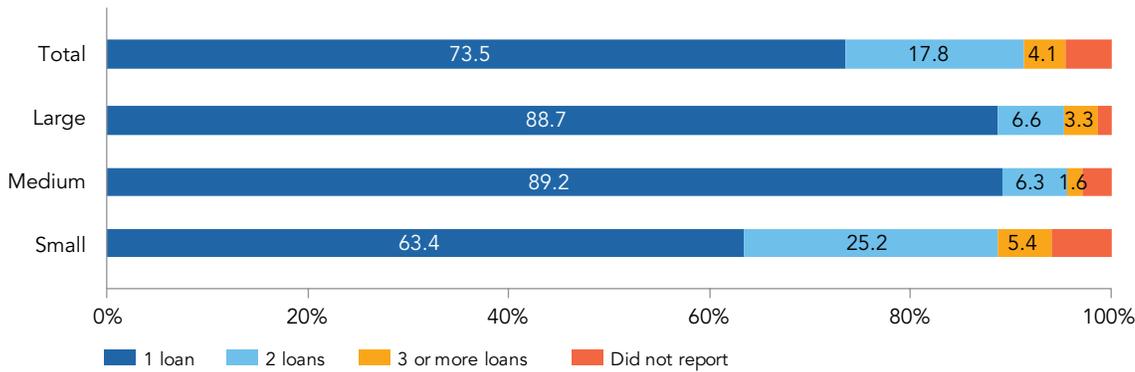
Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of fixed assets (in the fiscal year prior to the survey) that were financed from each source. Percentages are displayed for all firms and for each firm size category.

When examining small firms, which have the highest proportion of female owners, significant gender disparities in credit utilization become apparent. Among small firms, nearly all those owned by women have no loans (96 percent), whereas 71 percent of those fully owned by men report having no loans. Gender disparities in credit usage extend to the intensity of borrowing as well. For small firms with credit, the likelihood of having two or more loans is 7.4 percent if the firm is female-owned, compared to 28.8 percent for firms owned by men. Overall, these findings might suggest the presence of gender barriers in credit markets, with small firms owned by women being less likely to utilize credit and, when they do, obtaining fewer loans.

Data from the Enterprise Survey reveals the proportion of outstanding debt relative to annual sales of small and medium enterprises in Lao PDR with an average of 9 percent. Small firms carry a mean outstanding debt of 7 percent of their annual sales, while medium and large enterprises average 9 to 18 percent, respectively. Despite the availability of various financial products (e.g., SME loans, working capital credit), many firms in developing countries struggle to access these, leading some to rely on alternative financial solutions such as personal loans obtained by owners. Notably, 63 percent of small firms with outstanding loans resort to personal owner loans to finance business activities, a pattern less observed among larger firms, where only 9 to 10 percent employ this method.

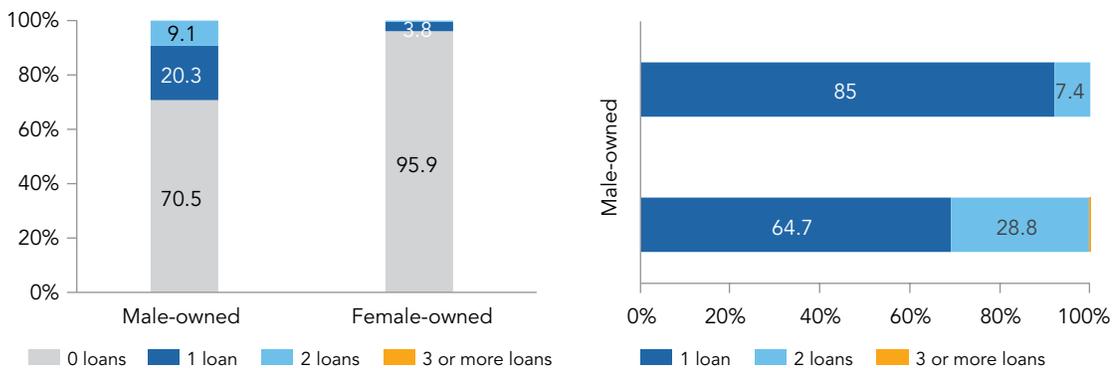
FIGURE 10: Number of outstanding loans



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms with 0, 1, 2 and 3 or more outstanding loans or active credit lines. Percentages are displayed for all firms and for each firm size category.

FIGURE 11: Number of outstanding loans of small firms, by gender of owner

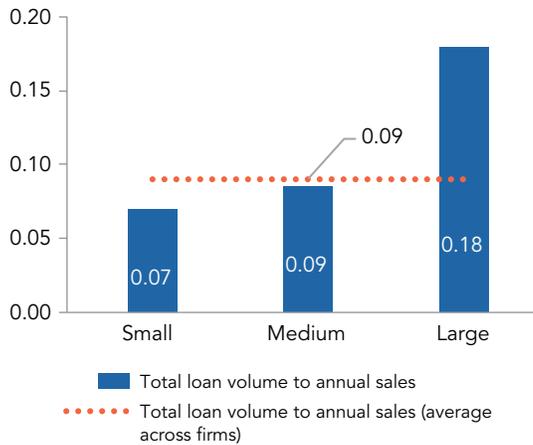


Source: Laos 2018 Enterprise Survey database.

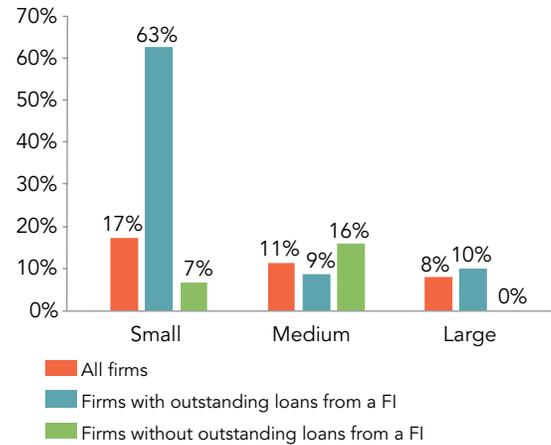
Notes: The figure plots the percentage of small firms with female vs. non-female owners with 0, 1, 2 and 3 or more outstanding loans or active credit lines. Percentages are displayed for all firms and for each firm size category. Two firms classified as small are not included in the figure because their information on female ownership is missing.

FIGURE 12: Credit depth

A. Outstanding debt of firms



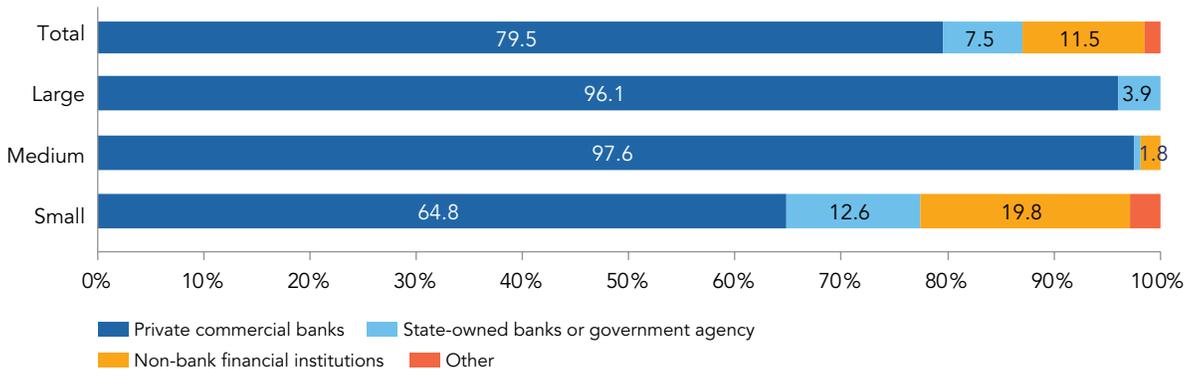
B. Firms' dependence on personal loans from owner



Source: 2018 Enterprise Survey database.

Notes: Panel A plots the average ratio of total outstanding debt to annual sales of all firms (horizontal dotted line) and of each firm size category (blue bars). Panel B plots the share of small, medium and large firms that use personal loans from the owners to finance their operations.

FIGURE 13: Financial institution that granted most recent credit



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms obtaining their most recent line of credit or loan from different financial institutions. Percentages are displayed for all firms and for each firm size category.

For firms that have credit, it is unsurprising that private commercial banks emerge as the predominant financial institution lending to firms, given Lao’s bank-dominated financial sector. Private banks granted the most recent credit of 79.5 percent of firms, followed by NBFIs, who granted 11.5 percent of loans. It is worth noting that since the data was collected in 2018, the percentage of credit granted by NBFIs might have increased since then given the expansion of the sector in 2019. When examining differences in lenders by firm size, more than 96 percent of medium and large firms (i.e., companies employing 20 workers or more) obtained their most recent credit from

banks. Small firms report a more diverse set of lenders for their most recent loans, with private commercial banks granting 65 percent of credits, NBFIs about 20 percent, and state-owned banks or government agencies responsible for 13 percent of loans.

To gain insights about the access to financial products and services by MSMEs excluded from the Enterprise Survey, the report analyzed data from the Informal Sector Business Survey (ISBS) and Findex data. The main findings for informal firms and agricultural entrepreneurs are summarized in Appendix B and C, respectively.

E. DEMAND-SIDE ISSUES UNDERMINING ACCESS TO FINANCE

The absence of physical collateral, typically demanded by private commercial banks, presents a significant obstacle for firms when accessing finance. In Laos, 93 percent of firms required collateral for their most recent commercial loan, with variations across financial institutions. Nearly all medium and large firms, mainly borrowing from private banks, necessitated collateral, while 88 percent of small firms, often borrowing from NBFIs, faced this obligation. Among small firms, the most prevalent collateral types were personal assets of the owners (e.g., houses) and establishment-owned land or buildings. Medium-sized firms were less inclined to use personal assets of the owners as collateral, with over 80 percent utilizing company-owned land or buildings instead. Although movable assets like machinery were seldom pledged as collateral for SME loans,¹⁵ 80 percent of large firms used this type of collateral in their latest credit. Other collateral forms were notably less common among large companies; for instance, only 30 percent of large firms were required to use their land or buildings as loan collateral.

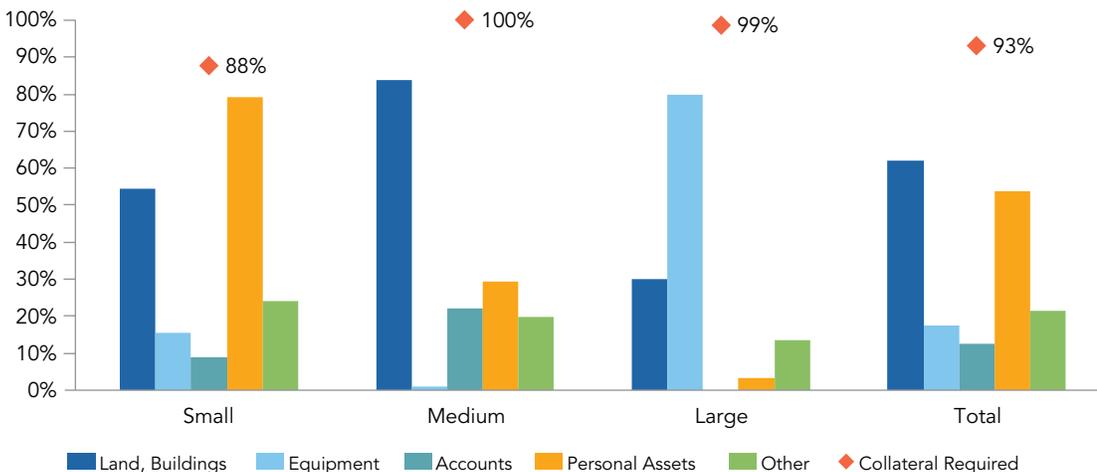
These excessive collateral requirements pose a significant barrier to financing. For those firms that were approved, they reported that collateral valuing 225.1 percent of the loan amount was required. Since collateral is typically taken in the form of land or real estate, this represents a significant impediment to SMEs. SMEs do not tend to hold significant assets in real estate, thereby constraining their ability to borrow. Globally, SMEs hold on average 78 percent of their capital stock in movable assets, such as vehicles, equipment, or inventory.¹⁶ Collateral requirements represent a huge impediment, particularly for smaller firms, where the loan value ratios often far exceed the value of collateral offered. For example, while large firms typically pledge collateral covering 120 percent of their loan value on average, small firms often offer collateral exceeding their debt by 5.5 times.

One notable finding from the Enterprise Survey is the limited engagement of firms with formal financial institutions for obtaining loans. In Laos, the majority of firms did not seek credit from the formal financial market in the year preceding the survey. Merely 15 percent of firms applied for a loan, and among them, a significant portion (11 percent) received approval. Interestingly, the percentage of firms abstaining from loan applications is substantial and consistent across small, medium, and large firms. On average, 59 percent of firms that abstained from seeking financing stated they did not require a loan, while

15. In 2022 and 2023, 0.3% of pledges recorded in the Secured Transactions & Collateral Registry relate to 'machinery', with 71% of them valued at ≤300 million kip. Notably, all pledges within this range were initiated by leasing companies such as AEON and KB KoLao. Additionally, there were very large pledges in this category initiated by a law firm in the hydropower sector. Furthermore, one commercial bank recorded five pledges in the range of 15-130 billion kip, indicating their involvement in the large enterprise segment (as per the GoL MSME definition, the ceiling of assets for medium enterprises is set at 4.8 billion kip).

16. Alvarez de la Campa and others, 2010.

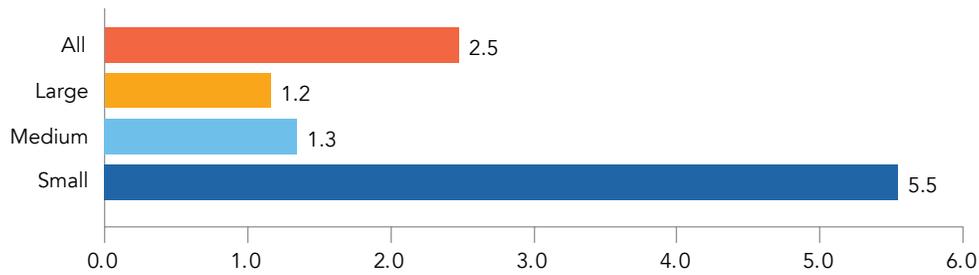
FIGURE 14: Collateral requirement for most recent credit



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms that in their most recent credit were required collateral (red diamond), and for those firms that were required collateral, the type of collateral they had to pledge. Land and buildings include those under the ownership of the firm. Equipment refers to all machinery and equipment including movables. Accounts refers to accounts receivable and inventories. Personal assets refer to assets under the ownership of the firm's owner (e.g., house). Other refers to other forms of collateral not included in the mentioned categories. Percentages are displayed for all firms and for each firm size category.

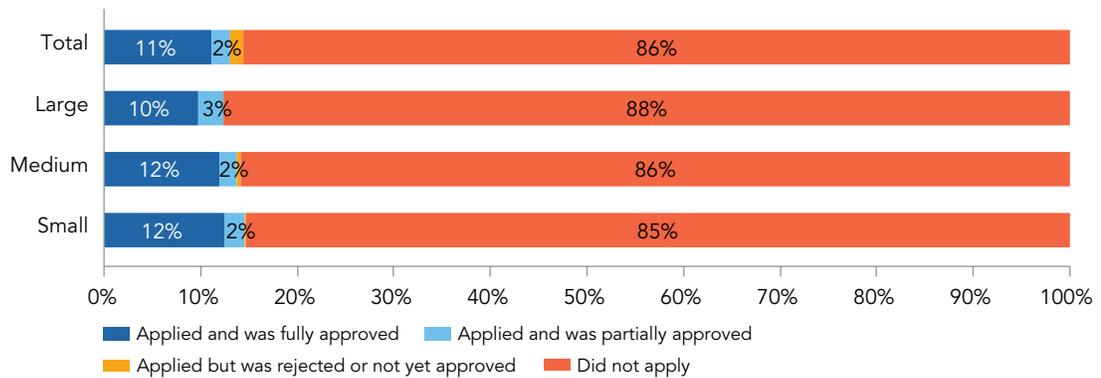
FIGURE 15: Collateral to loan value ratio of most recent credit



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the average ratio of collateral to loan value for the most recent line of credit or loan obtained by firms. Percentages are displayed for all firms and for each firm size category.

FIGURE 16: Loan applications in the last fiscal year



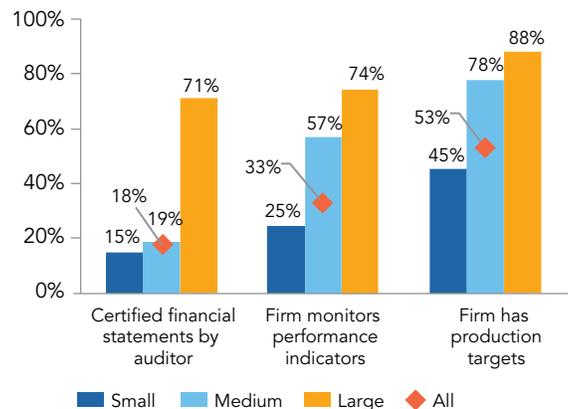
Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms (all firms and by size category) that in the fiscal year prior to the survey applied for a loan and were either fully approved, partially approved, or rejected (the latter includes firms that were not yet approved or that withdrew their application).

22 percent cited reasons such as the complexity of the application process or unfavorable loan terms (e.g., size, maturity, interest rate).

Access to finance challenges are exacerbated by inadequate business practices and managerial capacity. Disparities are evident across different firm sizes, with only 18 percent of formal enterprises in Laos possessing certified financial statements, primarily among smaller and medium-sized firms. In contrast, 71 percent of large companies have certified financial statements. Moreover, small firms are less likely to adopt beneficial managerial practices, such as professional goal setting and monitoring (Figure 17). Research indicates that robust business practices and managerial capacity significantly boost firm growth and productivity (Bruhn et al., 2018), consequently improving access to finance. Therefore, interventions targeting managerial constraints, particularly among small firms in Lao PDR, could enhance their performance and access to finance.

FIGURE 17: Business practices



Source: Laos 2018 Enterprise Survey database.

Notes: The figure plots the percentage of firms that had their financial statements checked and certified by an external auditor, that monitor production or service performance indicators, and that have production or service provision targets. Percentages are displayed for all firms (red diamonds) and for each size category.

V. OVERVIEW OF THE SUPPLY SIDE

A. OVERVIEW OF THE BANKING SECTOR

The financial sector in Lao PDR is dominated by commercial banks. While the involvement of non-bank financial institutions (NBFIs) targeting MSMEs has been growing, it remains relatively modest. This section will begin by outlining the structure of the banking sector in the country and its lending activities directed to MSMEs. It will then highlight significant developments within the NBFIs sector, which encompasses various institutions such as micro-finance institutions and leasing companies.

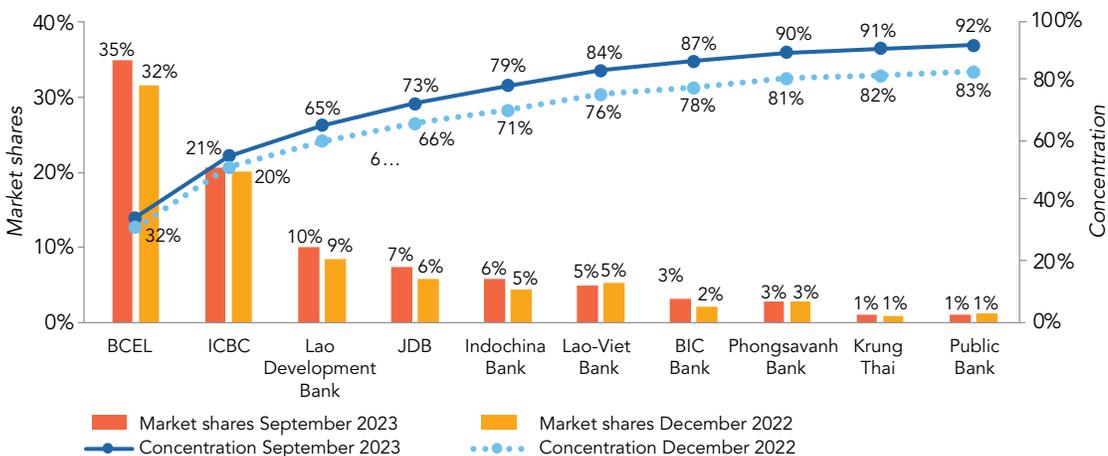
The number of commercial banks operating in the country increased slightly from 30 to 38 between 2012 to 2023. Currently, the banking landscape comprises one state-owned commercial bank (where the state’s share is above 50 percent), five joint state banks (with the state’s share below 50 percent), seven private domestic banks, one specialized bank, eight subsidiary banks, and 16 foreign commercial bank branches (Panel A of Figure 19). The largest commercial bank in terms of assets is the state-owned bank BCEL, which holds 35 percent of the sector’s assets. However, including joint-state banks, the percentage of the banking system with some level of state-ownership surpasses 50 percent.¹⁷ Recent amendments to the Law on commercial banks (No. 89/NA) have reduced the presence of foreign-owned banks due to increased capital requirements. Asset concentration has also risen, with the

top five banks holding 79 percent of total assets in 2023, up from 71 percent in 2022.

The physical outreach of the banking sector in Lao PDR is low, with only three commercial bank branches and 28 ATMs per 100,000 adults (Panel B). The low physical outreach of banks is further highlighted when comparing Lao PDR with peer countries in the region (Panels C and D). Unlike in other countries, such as Cambodia, where the physical footprint of banks has expanded in recent years, Lao PDR has seen little change in the number of branches and ATMs since 2017. However, there has been some expansion in the network of banking agents - shop owners contracted by retail banks to provide basic cash-in/cash-out services. The number of banking agents increased from 1,544 in 2020 to 1,998 in Q3 2023, while mobile money agents grew from 8,429 to 9,972 during the same period. Despite this moderate growth in physical outreach, banks have managed to attract more depositors over time, with the number of depositors in commercial banks increasing by 25 percent, reaching 675 depositors for every 1,000 adults in 2021 (Panel B). While the physical outreach of the financial system has grown little in recent years, there has been a rapid expansion of digital financial services (Panels A and B of Figure 20), mostly led by electronic money transfers and electronic payment systems (Panels A and B of Figure 21). This growth in digital finance has also been observed when looking at the yearly number of mobile banking, e-money accounts, and to a lesser extent, of internet banking accounts (Figure 22).

17. Not including recently privatized APB, which does not publish financial statements.

FIGURE 18: Market shares and asset concentration

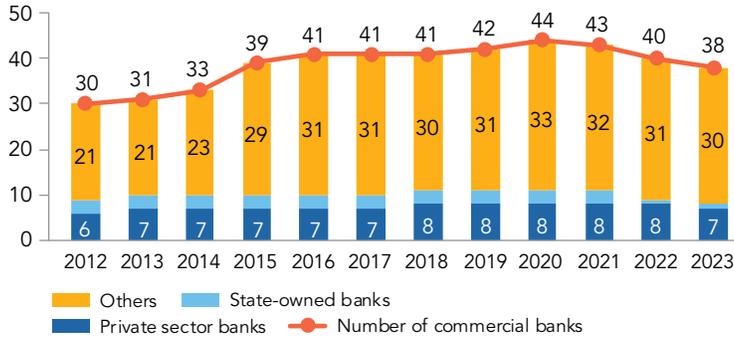


Notes: The figure plots the market shares and asset concentration in 2023 and 2022 for the 10 largest banks in Lao PDR. Data obtained from World Bank team’s calculations. Market shares and concentration are based on assets.

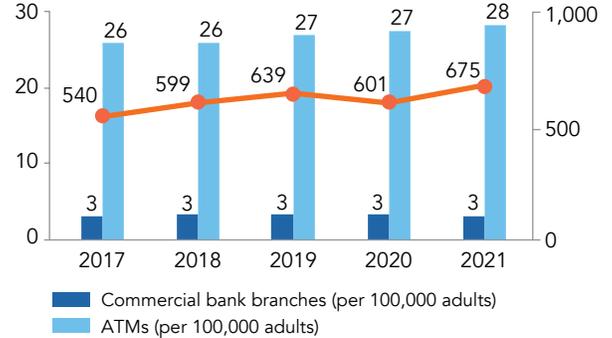
Commercial banks and their physical outreach

FIGURE 19: Commercial Banks and their physical outreach

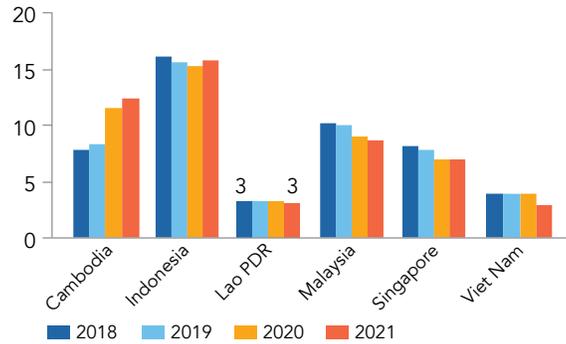
A. Number and type of commercial banks



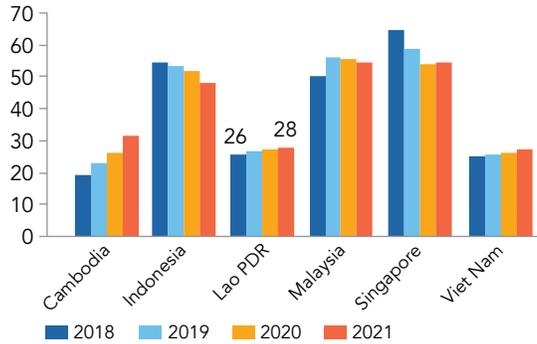
B. Commercial bank branches, ATMs and depositors



C. Commercial bank branches per 100,000 adults (regional comparison)



D. ATMs per 100,000 adults (regional comparison)



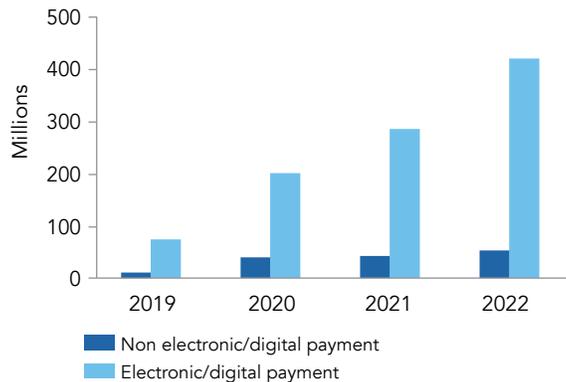
Sources for Panel A: ADB Asia SME Monitor 2023 database. Data on 2013 from Annual Economic Report 2013; updated by BOL. Data from 2023 obtained from BOL.

Sources for Panels B, C and D: International Monetary Fund, Financial Access Survey.

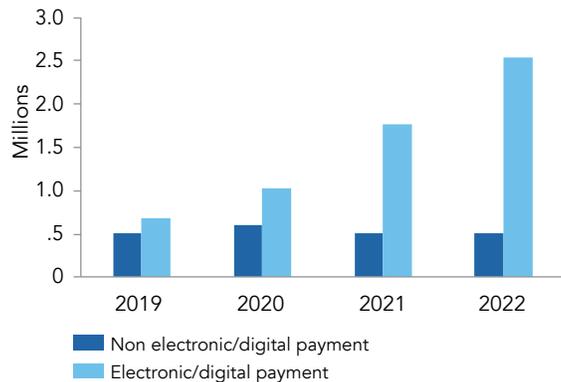
Notes: Panel A plots the number of commercial banks operating in Lao PDR. Others include joint state commercial banks, subsidiary banks, and foreign commercial bank branches. Panel B plots the ratio of commercial bank branches and ATMs per 100,000 adults, and the ratio of number of depositors with commercial banks per 1,000 adults. Panels C and D plot the regional comparison of bank branch and ATM penetration.

FIGURE 20: Growth of electronic and non-electronic transactions

A. Number of transactions



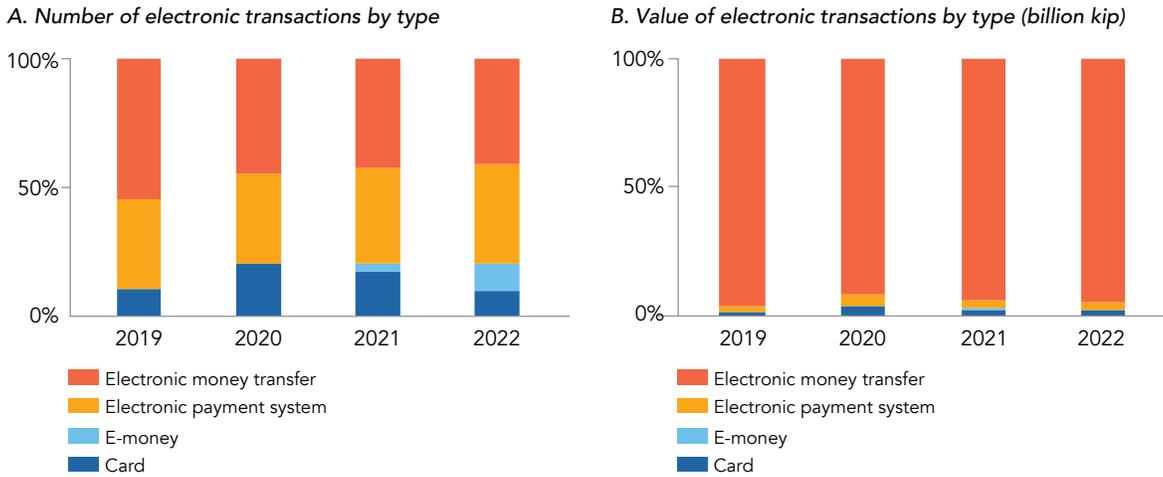
B. Value of transactions (billion kip)



Source: Data on the payment system from BOL.

Notes: The figure plots the number of electronic and non-electronic transactions (Panel A) and their value in billion kip (Panel B) from 2019 to 2022.

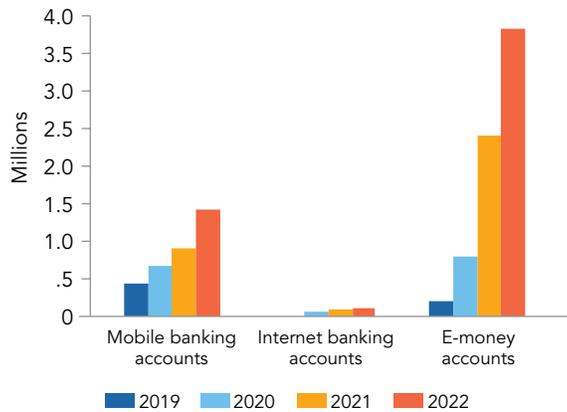
FIGURE 21: Growth of electronic transactions by type



Source: Data on the payment system from BOL.

Notes: The figure plots the number of electronic transactions (Panel A) and their value in billion kip (Panel B) by type of transaction, from 2019 to 2022.

FIGURE 22: Yearly number of mobile, internet and e-money accounts



Source: Data on the payment system from BOL.

Notes: The figure plots the number of mobile banking, internet banking and e-money accounts from 2019 to 2022.

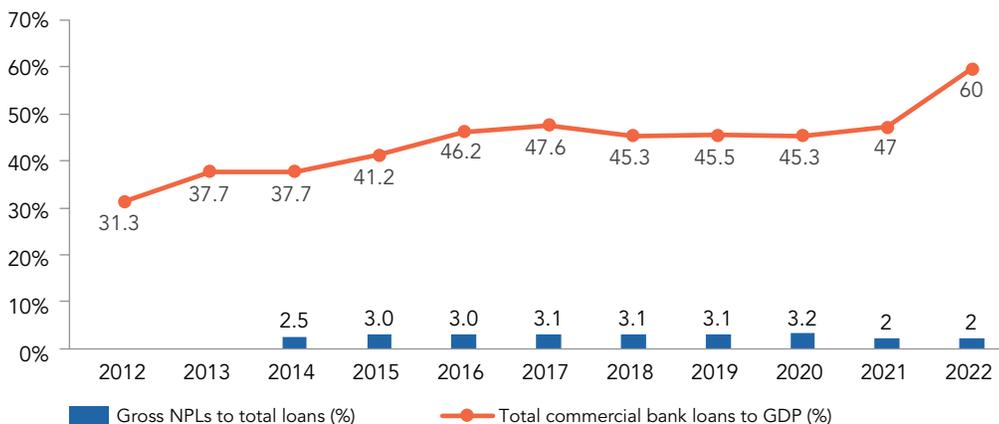
The financial depth of banks has witnessed significant growth over time, particularly in their lending activities, with bank credit rising from 31 percent of GDP in 2012 to 60 percent of GDP by 2022. The surge in credit expansion between 2021 and 2022 was mainly driven by lending interventions during the COVID-19 epidemic and the impact of the exchange rate depreciation (World Bank 2023a). As the economy reopened in 2022, there was a recovery in loan demand, leading to further acceleration in credit growth. Moreover, the recent recapitalization of two joint state commercial banks, namely the Lao Development Bank and the Agricultural Promotion Bank, has

bolstered their capital adequacy ratios (CARs), enabling them to resume normal lending activity. The robust loan growth may also be attributed to the improved financial position of several banks and construction companies following the government’s arrears resolution in 2021.

As of the end of 2023, the banking sector’s total credit represents an average of 50 percent of the system’s total assets, with approximately 70 percent of loan portfolios denominated in foreign exchange (FX). While the loan-to-deposit ratio of banks has been declining, the IMF warns of low liquidity ratios within the system and term mismatches on FX balance sheets due to a shift by depositors to FX deposits. However, local currency liquidity conditions significantly eased in 2023, propelled by a rebound in deposit growth subsequent to the redemption of central bank bills at the end of 2022.

Despite this expansion, overall credit risk in the banking sector appears relatively stable, as indicated by the reported aggregate non-performing loan (NPL) ratio (Figure 23). However, asset quality and loan-loss reserve coverage vary across banks. The true loan quality might be obscured by the pandemic-induced regulatory forbearance measures, with restructured loans accounting for 6–7 percent of total outstanding loans as of end-2022, as well as possible evergreening or inaccurate reporting. Additionally, uncleared expenditure arrears linked to government projects may persist on banks’ balance sheets as performing loans categorized under the “special mention” category. Consequently, there is a risk of substantial increase in NPL levels once COVID-19 related regulatory

FIGURE 23: Total bank credit to GDP



Source: ADB Asia SME Monitor 2023 database. Data on 2013 from Annual Economic Report 2013; updated by the Bank of the Lao PDR.

forbearance is completely withdrawn, and contractors’ loans related to remaining government expenditure arrears are classified as bad debt.

The rebound in loan growth has contributed to the improved overall profitability of the banking system, evidenced by increased return on assets and equity, although some banks reported weaker profits or larger losses in 2022. Another area of concern is the sector’s capitalization, which has shown a slight decline over time. While the capital-to-assets ratio stood at 11 percent in 2018, it dropped to 7 percent by 2023. Capital injections, including those received by the two joint state commercial banks in 2021, raised the aggregate Capital Adequacy Ratio (CAR) to 18.7 percent as of Q4 2022, surpassing the minimum regulatory requirement of 8 percent. However, the CAR remained relatively low among local banks. More granular data suggests that the decline in CAR is attributed to one large individual bank (BCEL), whose CAR is well below the regulatory minimum of 8 percent.

MSMEs, facing access to finance as their primary business obstacle, have not reaped the benefits of the considerable credit expansion by commercial banks in recent years. Data from the ADB Asia SME Monitor reveals a concerning trend: depicted in Figure 26, the share of bank lending directed to MSMEs has been steadily decreasing, from 30.9 percent of banks’ total lending in 2015 to a mere 12 percent in 2022. Additionally, MSME bank lending has declined relative to the size of the economy, dropping from 12.7 percent of GDP in 2015 to 7.2 percent in 2022.

The contraction of lending to MSMEs coincides with an expansion of bank lending to the government in recent years. From 2019 to 2023, bank lending to the govern-

Trends of the banking sector

FIGURE 24. Profitability

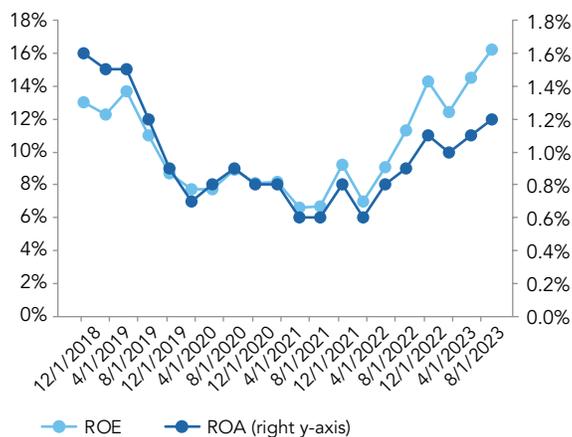
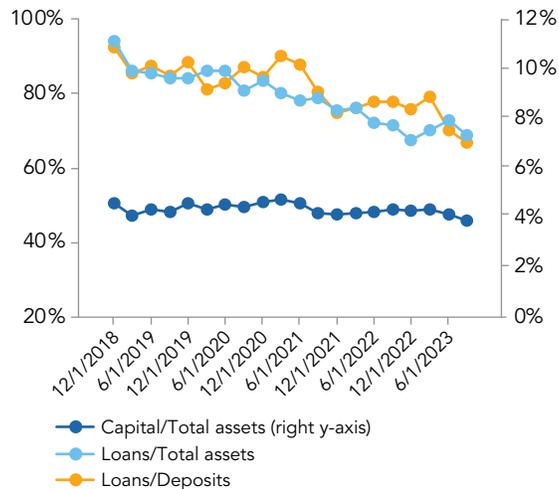


FIGURE 25. Loan and capital ratios



Source: ADB Asia SME Monitor 2023 database.

FIGURE 26. Bank lending to MSMEs

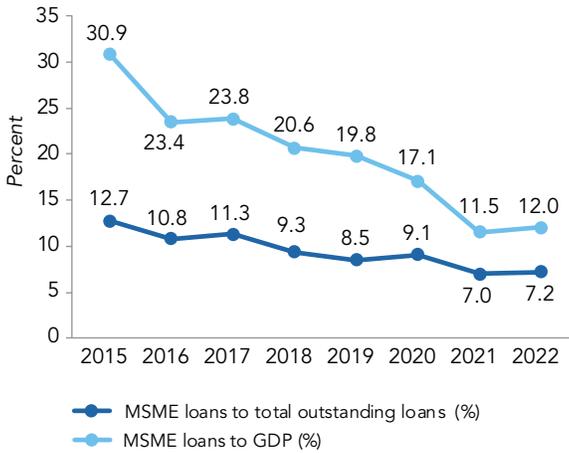


FIGURE 27: Exposure to government borrowing

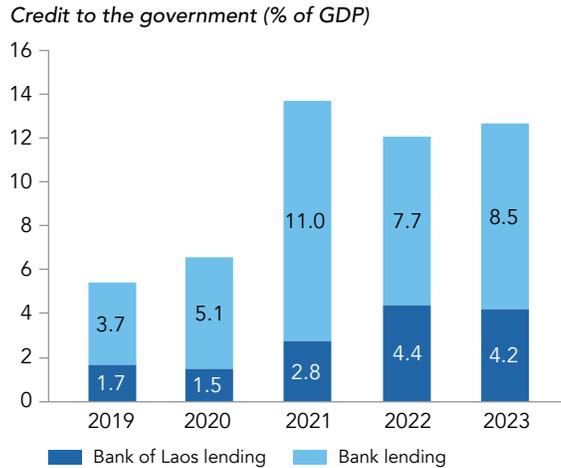
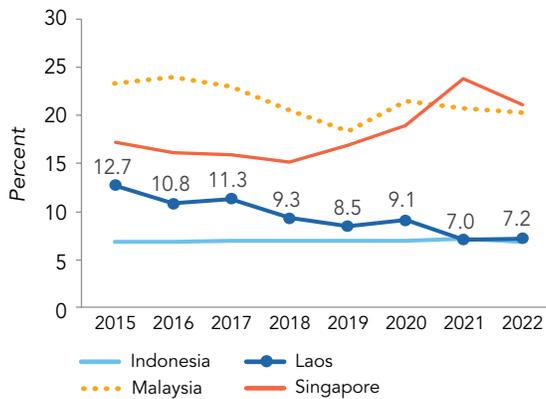
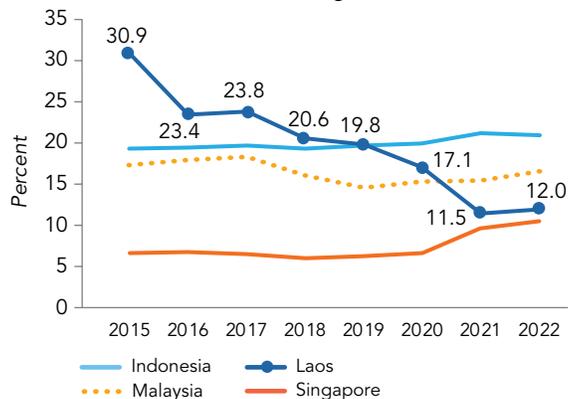


FIGURE 28: Bank lending to MSMEs (regional comparison)

A. As a share of GDP



B. As a share of total bank lending



Source: ADB Asia SME Monitor 2023 database.

ment increased from 5.1. to 8.5 percent of GDP (Figure 27). While anecdotal evidence from multiple interviews with government and bank officials indicates that banks have also expanded their lending into the large private corporate sector, data to examine this trend is not available.

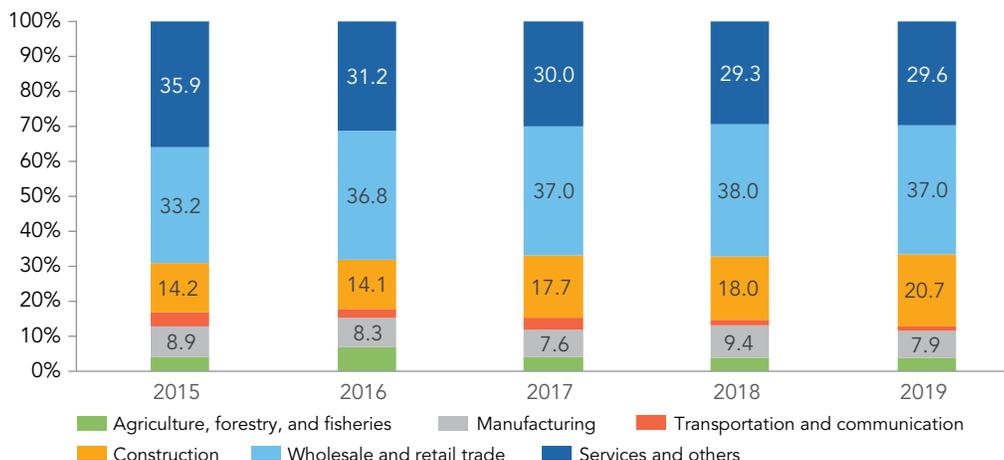
This is significantly lower than in many other countries in the region for which comparable data is available (Panels A and B of Figure 28).

Despite the declining share of bank credit to MSMEs, two noteworthy patterns emerge from the sectoral distribution of bank lending to this segment. Firstly, the allocation of credit across sectors has remained relatively stable over the years (Figure 29). Secondly, the distribution of credit across sectors does not align with the sectoral composition of MSMEs (Figure 30). For instance, in the construction sector, which comprises only 2 percent of MSMEs,

firms in this industry receive 21 percent of the financing allocated to MSMEs. Conversely, the trade sector, which accounts for 61 percent of MSMEs, receives only 37 percent all MSME bank credit.

While banks express their commitment to innovation, their product offerings remain largely traditional and lack novelty. Primary credit facilities include investments and working capital loans, along with leasing options restricted to vehicles primarily used by individuals. The absence of factoring, trade finance, movable assets-based loans, and overdraft facilities for MSMEs is conspicuous. Minimal investment has been made in developing risk-based lending capabilities, which limits the availability of targeted products for productive purposes. Banks have yet to explore alternative information sources or collaborate with fintech providers to enhance credit risk assessments for the unbanked and underbanked.

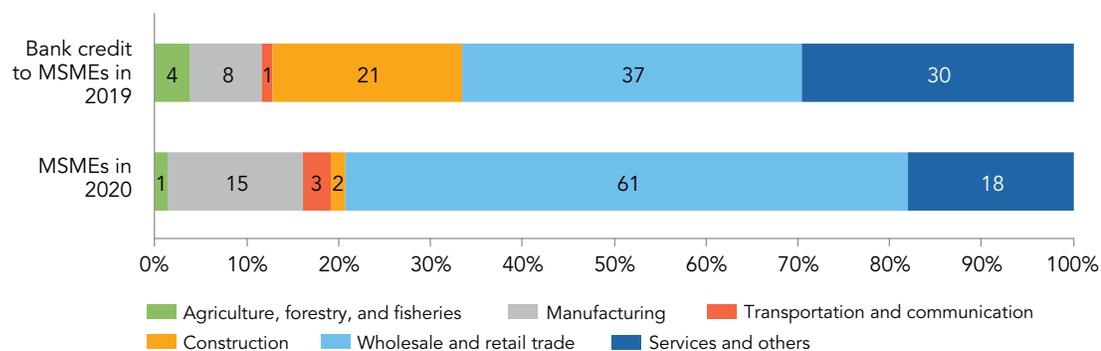
FIGURE 29: Sectoral distribution of bank lending to MSMEs over time



Source: ADB Asia SME Monitor 2023 database.

Notes: Data on the sectoral bank lending to MSMEs in Laos is available until 2019.

FIGURE 30: Sectoral distribution of MSMEs and their bank credit



Source: ADB Asia SME Monitor 2023 database.

Notes: Data on the bank credit to MSMEs by sector in Laos is from 2019. Data on the sectoral distribution of MSMEs is from 2020.

An analysis of commercial banks’ MSME loan portfolios covering half of the domestic market reveals that short-term loans are predominantly accessible only to large and medium enterprises, with limited availability for small and micro enterprises due to high transaction costs. However, working capital credit constitutes 30 percent of MSMEs’ bank credit, compared to 70 percent for investments, suggesting a medium-term duration that may not align with the business cycle of most MSMEs. The split between local currency and foreign currency credit (FX) is assumed to be primarily in kip, as few MSMEs can demonstrate regular export or FX revenues. Moreover, banks may be discouraged from lending to MSMEs with sales in KIP given that most of their deposits are in foreign currency.

The MSME segment is notably underrepresented in the surveyed commercial banks’ corporate loan portfolio: large enterprises constitute 89 percent, medium enter-

prises 9 percent, small enterprises 2 percent, with the micro segment being negligible. However, MSMEs are better represented in the working capital category, with medium enterprises receiving 17 percent of the financing and small enterprises 4.8 percent. Profitability is the most frequently cited driver for MSME lending, although there is no consensus on the drivers for each bank, reflecting specific issues. Views on obstacles are heterogeneous; while most banks consider the MSME segment less profitable than large enterprises, perceptions of relative risk vary. Loan administration is considered significantly costlier than for large enterprises.

Land or real estate serves as the preferred form of collateral across the board, although its significance usually follows a financial assessment of the business in credit underwriting decisions. Most banks place equal value on the length of the relationship with the company applicant,

TABLE 3: Selection of bank credit products

NAME	BCEL	LDB	APB	LVB
Utilization	Fixed Assets Working Capital	Fixed Assets Working Capital	Fixed Assets Working Capital	Fixed Assets Working Capital
Interest rate	8.25% ≤1 year 8.5% 1-5 years 9.0% >5 year	9.5-11%	11.3–12%	N/A
Collateral	x1.25 loan size ¹⁸	x1.7 loan size for land /building x1.1 for bank deposit	x1.4–1.7 loan size, mostly land / building x1.1 for bank deposit	N/A

with notable exceptions from challenger banks proactively prospecting. Following this, the credit information company (CIC) report is typically considered, with only one of the surveyed banks disregarding this factor.

The primary reasons cited for rejecting loan applications are the lack of a business plan, absence of evidence of business transactions (inactive bank accounts), and the absence of a formal business license (at a minimum the MoIC company registration, but also expecting the sectoral business license from the concerned line ministry). A risk factor mentioned is credit outside the regulated financial system, which creates a liability that the credit bureau cannot capture. All financial service providers can now also check whether an MSME loan applicant is current with its tax liabilities: some private banks consider it an absolute prerequisite, while others are more flexible, acknowledging that settling tax arrears is a complicated and lengthy process.

Banking records can compensate for the absence of proper accounting to determine evidence of revenues, but the challenge lies in obtaining electronic records to expedite analysis. BCEL declares that if more than half of revenues are recorded through the bank account, it gives a strong advantage for the credit decision. Other banks generally favor bank statements but face analysis hindrances due to paper account statements; they highly value electronic bank statements for quick processing, which are unfortunately not available on retail mobile-banking platforms. The Open-Banking initiative pursued by BoL/PSD (similar to the landmark ECB PSD2 regulation) aims to bridge this gap.

While more rigorous evidence analyzing gender barriers is needed, the descriptive statistics might provide suggestive evidence that women-led enterprises appear to face disadvantages in accessing banking credit. Among the few banks monitoring their loan portfolio gender-wise,

women-led enterprises account for only 10-25% of the total MSME loan portfolio.

B. THE NBFI SECTOR

While commercial banks dominate the financial sector in Lao PDR, there has been significant growth in the NBFi sector in recent years, with the number of NBFIs increasing from 90 to 247 over a ten-year period (Figure 31). This sector encompasses a diverse array of financial institutions, including deposit-taking (DTMFIs) and non-deposit taking microfinance institutions (NDTMFIs), pawnshops, leasing companies, and credit unions and cooperatives, which primarily serve smaller and more informationally opaque clients such as MSMEs.

The sector is expected to concentrate with a sharp reduction of NDTMFIs when the 2-year adjustment period for the new capital rules issued in June 2022 ends in June 2024.

While MFIs represent over half of the NBFIs in Lao PDR, a reform in 2019 spurred the growth of foreign direct investment into leasing companies, which were previously constrained by regulations prohibiting full foreign ownership (UNCDF, 2021).¹⁹ By 2022, NBFIs had reached 215,923 clients, marking a ten-fold increase from the 21,000 clients they had a decade earlier (Figure 32). Much of this growth aligns with the significant expansion of leasing companies, which now serve a similar number of clients as MFIs.

In Lao PDR, like many other developing and developed countries, the lending activities of NBFIs remain modest compared to commercial banks and the overall size of the economy. When compared to peer countries in the region, Lao PDR's NBFi sector is similar to Indonesia's, with NBFi lending comprising around 3 to 4 percent of GDP and bank lending to MSMEs representing about 7 to 9 percent of GDP. Laos' NBFi sector

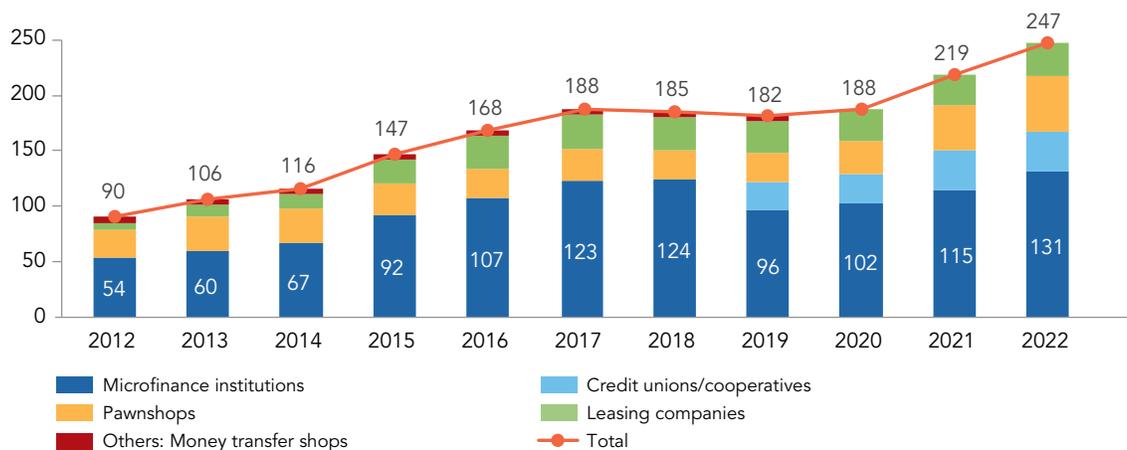
18. Promotional offer for MSMEs, before 1,7x. Mostly land or real estate but can accept vehicles and machinery that would be recorded as pledge in the Movable Assets Registry.

19. Since 2019, the surge of credit by leasing companies is driven by Krung Sri Leasing and AEON, both fully foreign-owned. Recently, non-deposit taking microfinance institutions (NDTMFIs) have also been allowed to be fully owned by foreign capital.

TABLE 4: Comparison of Capital Requirements for Various Categories of NBFIs

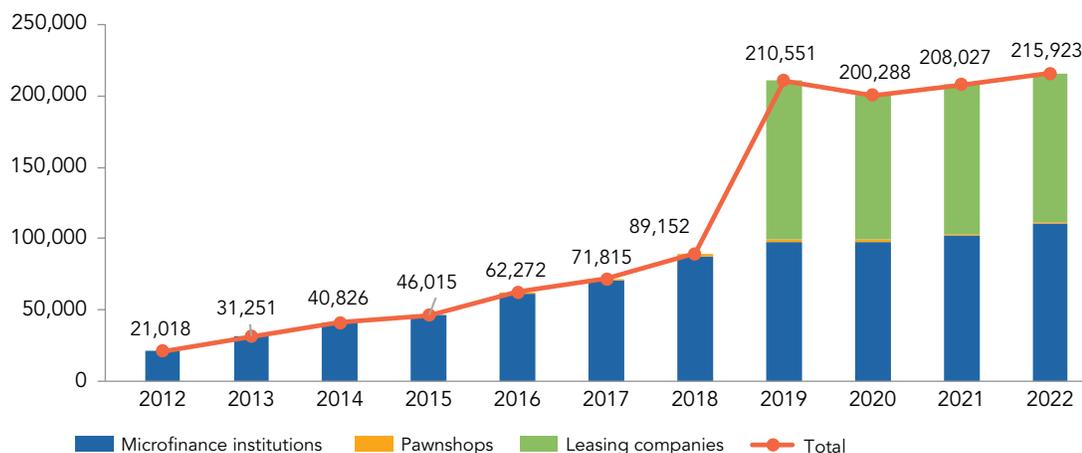
TYPE OF NBFIs	PREVIOUS CAPITAL REQUIREMENT (KIP BILLION)	CURRENT CAPITAL REQUIREMENT (KIP BILLION)
Pawn Shop		1,000
Leasing company		5,000
Saving and Credit Union		500
Non-Deposit Taking Microfinance Institution	October 2012 200	June 2022 10,000
Deposit Taking Microfinance Institution	October 2012 3,000	June 2022 30,000

FIGURE 31: Number of NBFIs



Source: ADB Asia SME Monitor 2023 database. Data on 2013 from Annual Economic Report 2013; updated by the Bank of the Lao PDR.

FIGURE 32: Number of clients, by type of NBFIs



Source: ADB Asia SME Monitor 2023 database. Data on 2013 from Annual Economic Report 2013; updated by the Bank of the Lao PDR.

surpasses the NBFIs sectors of peer countries with more developed banking sectors. For instance, in countries such as Malaysia and Viet Nam, where bank lending to MSMEs represents more than 20 percent of GDP, NBFIs sector lending is less than 1 percent. Notably, Cambodia stands out in the region for its significant NBFIs lending levels and rapid growth, both relative to commercial banks and GDP (Panels A and B of figure 33).

A closer look at various NBFIs reveals interesting dynamics. Prior to the COVID-19 pandemic, NBFIs lending volumes had been increasing rapidly, albeit from a small base. In 2019, the total credit provided by NBFIs amounted to 3.7 percent of Lao PDR’s GDP and 8.5 percent of the total bank credit in the country (Panels A and B of figure 33 and Figure 41). By comparison, NBFIs credit in 2012 represented only 0.1 percent of GDP and 0.4 percent of banks’

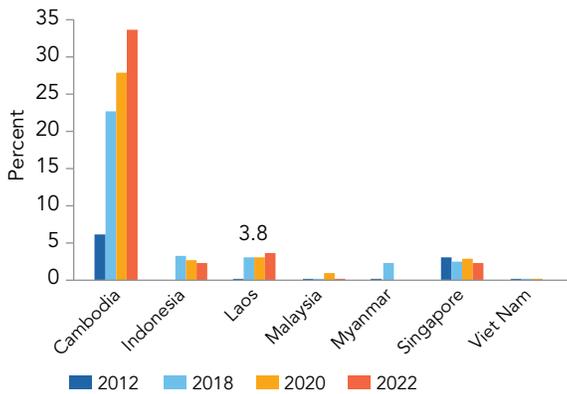
credit. However, at the onset of the pandemic, NBFi credit growth declined, both relative to total bank credit and GDP. In 2020, leasing companies – the primary drivers of the credit expansion in the pre-pandemic years–experienced the most significant contraction in credit. Since 2020, NBFi total credit has remained relatively steady but has not yet returned to its pre-pandemic levels. The

growth of the NBFi segment received a boost from FDI into the leasing sub-segment in 2018.

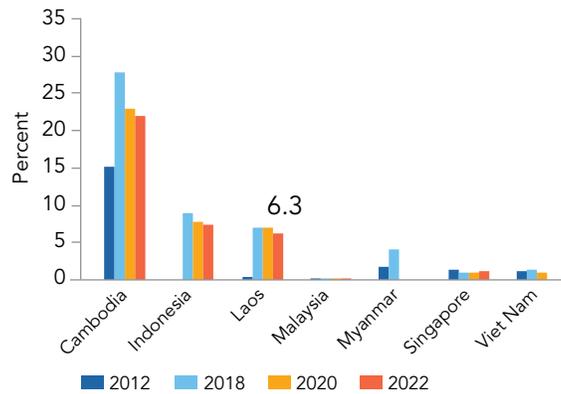
Data on the financial health of each type of NBFi, measured by the NPL ratio, is available from the ADB Asia SME monitor for 2020 onwards. As depicted in Figure 34, MFIs, pawnshops and leasing companies have pro-

FIGURE 33: NBFi financing in Lao PDR and its peer countries in the region

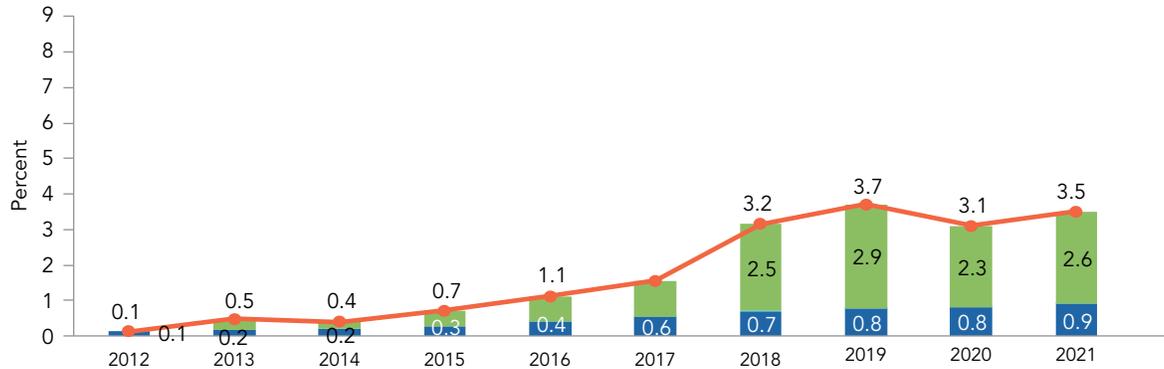
A. As a percent of GDP (regional comparison)



B. As a percent of total bank credit (regional comparison)



C. As a percent of GDP (In Lao PDR)



D. As a percent of total bank credit (In Lao PDR)



Source: ADB Asia SME Monitor 2023 database.

gressively decreased their NPL ratios over time, reaching NPL rates in 2022 that closely resemble those of commercial banks.

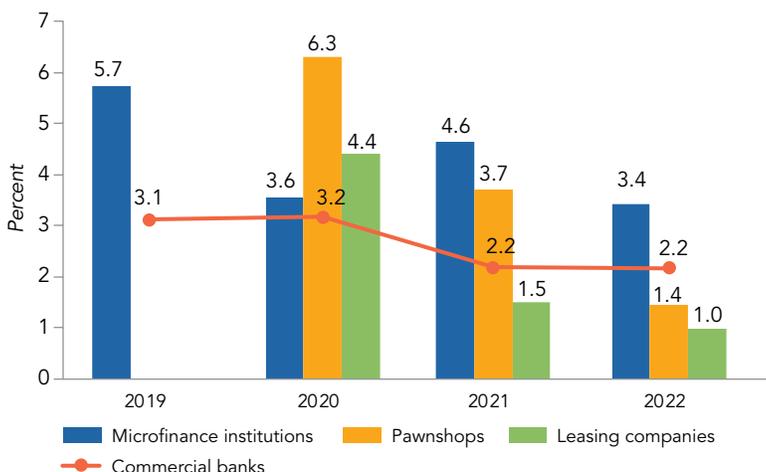
In light of challenges in accessing bank credit, NBFIs, particularly the DTMFIs, provide an alternative financing option for MSMEs, albeit at higher interest rates compared to banks (See Table 5, leasing companies typically

do not differentiate MSMEs from individuals in their offerings, mainly focusing on vehicles financing.²⁰)

The coverage of NBFIs in Lao PDR is uneven, lacking nationwide representation with the largest DTMFIs operating in only 4–5 provinces, leaving numerous areas unserved. Despite efforts such as credit officers traveling to clients’ locations for loan appraisal and repayments, many regions remain underserved.²¹ Leasing companies are predominantly located in urban centers due to the significant 100-billion-kip capital outlay required by BoL for provincial branch extension, hindering geographic expansion. Consequently, the total number of provincial branches for all 31 leasing companies remains at 16, mirroring the count of 19 DTMFIs.

The microfinance sector has shifted its focus away from women-led enterprises. Gender data from a DTMFI revealed that although 64 percent of borrowers are women, they represent only 49 percent of the outstanding loan amount, indicating their underrepresentation in the higher-size MSME loan segments. Previous sectoral data compiled by LMFA on its members indicates a

FIGURE 34: Non-performing loans of NBFIs (compared to commercial banks)



Source: ADB Asia SME Monitor 2023 database. Data on 2013 from Annual Economic Report 2013; updated by the Bank of the Lao PDR.

Notes: The plot displays the average non-performing loan ratios of different financial institutions. Data of commercial banks and microfinance institutions available since 2019. Data of pawnshops and leasing companies available since 2020.

20. Pledges with an enterprise ID are exceptional in the movable assets registry.

21. Source: ‘Mapping Study on Rural Finance Coordination and Provision in the Lao PDR’, September 2019, commissioned by the Task Force on Rural Finance (TFRF) under the Sub-Sector Working Group on Rural Development (SSWG-RD).

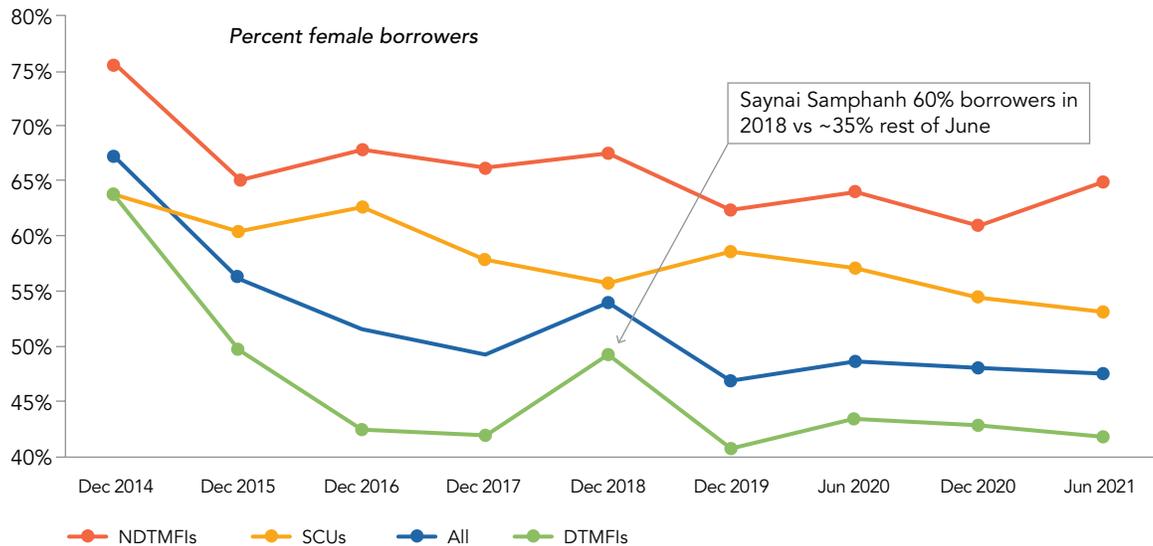
TABLE 5: Alternative options for different types of loans

TYPE	DTMFI	DTMFI	LEASING
Name	EMI SME loan	EMI Individual /group loan /salary loan	Krung Sri Leasing
Utilization	Fixed Assets Working Capital	Fixed Assets Working Capital	Vehicles ²² usually 5-year tenure
Size	50–300 million	0-49 million	20-200 million, median size 80 million
Interest rate	24% p.a. declining	37.8% p.a. declining, flat if size <5 million 33.5% p.a. declining for salary loan	8% p.a. flat = 14.1% APR ²³
Collateral	Land, building, vehicle <i>Informal land titles accepted in rural areas</i> ²⁴	Land, building, vehicle Uncollateralized for group loan DTMFI recognized as senior creditor by employer for salary loan, no other collateral required	Vehicle
Other terms	3-60 months No formal enterprise registration required.	3–60 months <i>3–24 months for group loan</i>	20% down payment

22. Trucks possible but weight <4t. (brand Isuzu), few loans in that category. Pickup cars very popular, can have business use case. Also leasing of second-hand cars and motorbikes.

23. Using Microfinance Transparency Int’l APR calculator. Advanced repayment possible by BoL regulation.

24. E.g. land titles issued by village or district authorities. The formal land titles (“golden”) are issued by the provincial department of MONRE.

FIGURE 35: Evolution of the share of female borrowers by type of MFI

Source: LMFA MFI Performance Monitoring www.laomfa.org. Compilation discontinued after June 2021. Lending volumes by gender are not tracked.

declining trend in the share of women borrowers, particularly among DTMFIs.

MFI, while giving more attention to micro- and small enterprises, face constraints including limited access to long term funding in kip, national payment systems, and innovations skills. Despite their greater rural presence compared to banks, their outreach remains restricted, hampering potential scalability. Notably, NDTMFIs, encounter challenges accessing long term funding in kip, relying primarily on internal resources due to limited funding options. Anecdotal evidence suggests a lack of borrowing from competitors like banks, affecting financing costs. Moreover, LAPNet, Lao PDR's main retail payments infrastructure, is controlled by banks, with a pricing structure favoring large transaction volumes. Fair access to LAPNet is crucial for promoting interoperability. Furthermore, limited innovation skills and lack of digitization among MFIs constrain MSMEs' access to finance, hindering the adoption of modern financial services and technologies.

Regulatory constraints further hinder MFIs from expanding their operations and extending credit to businesses. Prime Minister Decree No. 184 dated 20 June, 2022 mandates DTMFIs and NDTMFIs to have registered capital of 30 Billion and 10 Billion kip, respectively, up from 1 Billion and 200 million kip. These increased minimum capital thresholds are expected to drive sector consolidation upon the expiration of the 2-year transition period in June 2024, potentially forcing out players unable to meet the new standards, who may continue as informal

lenders. Additionally, the decree limits microfinance loan sizes to the amount permitted by the BoL in each period, constraining potential loan sizes for MSMEs. Initially set at 50 million kip in 2008, MFIs could allocate a maximum of 20 percent of their total loan portfolio above this threshold. While the ceiling was raised to 100-million-kip by the end 2022, the proportion of loans exceeding this limit was capped at 30 percent of their capital,²⁵ significantly reducing the permissible portfolio of larger loans. This rule poses challenges for MFIs catering to MSME clients, as they may struggle to retain them as they seek larger loan sizes and more sophisticated banking services.

C. ALTERNATIVE FINANCIAL PRODUCTS

Access to private investment, equity funds, and venture capital for startups and entrepreneurs in Laos is limited, with most relying on personal savings for start-up capital. There's a crucial need for patient capital to support business expansion, yet suitable financial instruments are scarce. While several investment funds previously targeted MSMEs, currently, only one fund provides debt to MFIs and MSMEs, primarily in agribusiness, though the pipeline of investment-ready companies remains limited.

Innovative financial products are rare, with banks mainly offering traditional loans with fixed collateral. Adoption of alternative products better suited to finance needs is limited. Financial leasing, crucial for acquiring equipment without utilizing available cash, is hampered by the scar-

25. BoL Decision N° 870, dated 14 November 2022

city of operational leasing companies. Challenges include enforcement issues, limited awareness, and the absence of long-term funding. Despite regulations governing leasing, challenges persist in repossession procedures and the secondary market for assets.

Furthermore, factoring, P2P lending, and crowdfunding are either nonexistent or underdeveloped, while Fintechs are still emerging in Laos and do not offer MSME lending products. Challenges in digital finance include limited interoperability and low merchant payment acceptance. Although opportunities exist for digitalizing government payments to businesses through platforms for electronic invoices, they are constrained by deficiencies in public financial management.

Increasing offer and uptake of innovative products could help unbanked and MSMEs access more finance and at better rates. For this reason, (further) development of the following financial products is needed: (a) accounts receivable finance (for example, factoring and reverse factoring), (b) secured revolving lines of credit (movable collateral), (c) financial leasing, and (d) P2P lending or crowdfunding.

A robust legal and regulatory framework is crucial for the advancement of alternative financial products as it helps mitigate perceived risks associated with finance, consequently lowering costs. Clear and transparent laws and regulations provide a certain and predictable foundation for product development, collateralization, and the enforcement of creditors' rights. This framework facilitates the creation of innovative products, enabling financial service providers (FSPs) to efficiently utilize improvements in credit infrastructure and capitalize on potential advancements in digital financial services.

Accounts Receivable Finance

Accounts receivable finance can serve as a vital tool for businesses facing financing gaps due to extended payment terms or delays. This form of finance enables financial service providers (FSPs) to extend financing to suppliers by purchasing their accounts receivable or invoices from larger clients, leveraging the creditworthiness of these clients. In Lao PDR, smaller suppliers often contend with extended payment terms imposed by larger clients, including the public sector. Late payments, while constituting a breach of contract, may be financially incentivized for debtors due to perceived leniency in penalty enforcement or inefficiencies in redress procedures.

However, accounts receivable finance remains underdeveloped in Lao PDR. Currently, specialized NBFIs do not offer this service, and there is a lack of available statistics

on offerings by banks. Banks typically restrict accounts receivable finance to established large corporate clients with a proven track record, often using receivables as collateral for standard business loans, rather than engaging in true factoring arrangements.

Establishing precise definitions for factoring products is crucial for their development. Currently, there's no legal definition in place. By explicitly defining factoring, market terminology can be standardized, improving understanding, especially for MSMEs. Clear definitions would also guide local courts in handling factoring transactions. This could be accomplished through standalone factoring legislation or by amending existing laws, depending on regulatory preferences. Ultimately, clear definitions would create legal certainty, fostering growth and accessibility of factoring services.

Introducing specific contract law rules tailored to factoring into Lao PDR's legal framework is vital. Currently, there are no regulations addressing factoring contracts and the rights and obligations of involved parties. Establishing a supportive legal framework is crucial to provide clarity and predictability for receivables finance. Additionally, implementing default rights for parties in accounts receivable transactions would enhance legal certainty and safeguard stakeholders' interests. This framework not only facilitates the development of receivables products but also guides local courts in understanding and supporting these transactions. Guidance could be issued by the BoL through new guidelines, outlining basic factoring rules and establishing a licensing framework for specialized business lending providers. Alternatively, integrating these rules into existing legislation or introducing them through other regulatory channels would nurture an environment conducive to the growth of factoring services in Lao PDR.

Purchase Order Finance

Purchase order finance is vital for companies grappling with cash shortages, enabling them to procure necessary inventory for fulfilling customer orders. This product empowers financial service providers (FSPs) to finance suppliers, facilitating timely manufacture and delivery of goods against buyer contracts, thereby strengthening inventory procurement, boosting sales prospects, and ensuring cash flow for prompt customer deliveries.

However, the growth of purchase order finance in Lao PDR faces obstacles due to arrears in both public and private sectors. Typically, this financing solution emerges from supporting sale contracts with public sector entities. Yet, chronic government arrears in Lao PDR present sig-

nificant challenges. Companies relying on preproduction finance struggle with uncertain payments from their contracts, often necessitating self-financing of public sector debts. While efforts are being made to reduce arrears, particularly in paying commercial obligations, more action is needed. The modernization of Laos PDR's public financial management systems can aid in controlling, monitoring, and minimizing arrears.

Furthermore, regulating payment terms to reduce arrears for small businesses would be beneficial, enhancing their working capital management and reducing finance costs. Introducing regulations on maximum payment terms in contracts for goods and services, following international examples, could foster a better payment culture. For instance, in India, the Ministry of MSMEs has introduced policies and guidelines to ensure timely payments to MSMEs by both government and private sector entities. Additionally, countries like Japan and South Korea have regulations in place to address delayed payments to small businesses.

Another challenge hindering the development of purchase order finance in Lao PDR is the inability to hedge against inflation by contracting prices in dollars or other reference rates for local B2B transactions. High inflation rates and the inability to hedge payments create pressure for prepayment, limiting orders and slowing economic activity. This barrier also impedes the growth of trade credit and purchase order finance.

Secured Revolving Lines of Credit

A secured revolving line of credit is used to provide working capital to mature or sophisticated MSMEs. MSMEs require credit to finance their entire production or business cycle. However, smaller businesses face greater obstacles and have less collateral to finance presale activities than to finance post-sale activities. Presale includes inventory acquisition, manufacturing, harvesting, and delivery of services.

Financing for presale activities against movable assets is rare in Lao PDR. Current asset-based finance products offered by banks are limited to vehicles. Other assets that smaller businesses might potentially have such as machinery that is not registered, inventory, goods in commerce, or receivables are not given much value, if any. Without presale financing the businesses themselves finance their large buyers, not the other way around. Current asset-based finance products mainly focus on vehicles, neglecting other potential assets like machinery, inventory, or receivables. This leaves businesses to self-finance during critical phases, unless they possess immovable assets,

which is uncommon. The development of such credit lines is hindered by the absence of necessary know-how, out-of-court enforcement mechanisms, and a well-functioning secondary market for collateral resale.

Addressing these challenges requires both expertise at the FSP level and the establishment of a robust secondary market for collateral resale. FSPs need to develop skills in asset identification, valuation, and resale, while also improving liquidity in the secondary market. Digitalization of financial services can streamline the process by ensuring collateral support for borrowing requests, linking to e-invoicing systems for receivables verification, and integrating with warehouse management software for inventory monitoring. In economies with advanced electronic invoicing frameworks, direct interoperability with tax authorities and borrower accounting software can further enhance lending processes for sophisticated businesses.

Financial Leasing

Limited financial leasing options are available in Lao PDR, primarily focusing on vehicles, motorbikes, and consumer electronics. Machinery leasing, though rare, has been attempted on a small scale by providers such as Krung Sri Leasing, setbacks due to past defaulting incidents have been observed. The 2021 Decree on Leasing Businesses governs leasing activities, and the regulatory framework does not seem to hinder financial institutions from offering leasing services.

However, challenges such as enforcement issues, limited secondary markets, and insufficient long-term funding for financial service providers persist. Repossessing assets, while not requiring a court order and facilitated by local authorities, remains a lengthy process. Concerns about the scarcity of secondary markets for repossessed assets hinder leasing activities. Financial institutions offer only a limited range of assets for leasing, mainly those with more robust secondary markets. Moreover, the lack of access to longer-term funding poses a challenge for non-bank entities to offer leasing products exceeding three years. Additionally, customer unfamiliarity with leasing and the lack of leasing expertise among financial service providers are viewed as hindrances to leasing development.

Peer-to-Peer Lending and Investment-Based Crowdfunding

Currently, no P2P lending or investment-based crowdfunding platforms operate in Lao PDR, despite the global and regional growth of these options. Introducing regulations for operating conditions and establishing necessary protections for investors and consumers has facilitated the

emergence of these platforms in other countries, exemplified by the recent P2P lending roadmap launched by OJK in Indonesia.

P2P lending and crowdfunding have the potential to attract informal finance flows into regulated and secure platforms, offering quick and convenient credit to MSMEs. Key benefits include minimal paperwork, low risk of loan denial, simplified customer experience, and faster loan application processing, particularly appealing to MSMEs for their quick and flexible loan processes. However, the absence of a regulatory framework currently renders such operations illegal in Lao PDR.

The introduction of a regulatory framework could support P2P lending, necessitating clear rules on licensing of platform operations and prudential and market conduct requirements. According to the Cambridge Centre for Alternative Finance study, the presence of clear regulations or supportive signaling by regulators correlates with increased market activity. Therefore, the ongoing efforts to regulate nonbanking finance activities should be leveraged to recognize P2P lending as a legitimate financial service and develop implementing guidelines and regulation.

Similarly, investment-based crowdfunding requires specific legal and regulatory recognition, following global good practice to reduce the cost of issuing and trading securities of small businesses. Creating specific rules for crowdfunding can mitigate regulatory barriers for MSMEs seeking capital market access. Although relatively new, internationally regulator approaches have already emerged to address or mitigate risks, especially those faced by potentially uninformed consumers. Some of these are highlighted below in Table 6. Additionally, to support the development of these “mini capital markets,” jurisdictions globally offer tax incentives to professional investors in MSME securities, making investment in MSMEs more attractive.

Although formal remittances inflows accounted for less than 2 percent of Lao PDR’s economy in 2022,²⁶ and it could be beneficial to explore the diaspora’s interest in investing in local MSMEs through platform finance. Lao PDR boasts a significant diaspora worldwide, estimated to range from hundreds of thousands to over a million individuals, holding considerable financial and human capital. Despite this, their interest in the country’s development

26. See <https://data.worldbank.org/indicator/BX.TR.F.PWKR.DT.GD.ZS?locations=LA>

BOX 1

Regulators Realizing the Potential Benefits of Investment-Based Crowdfunding

The growing recognition of Investment-Based Crowdfunding’s potential to enhance small business financing has spurred regulators worldwide to adapt their frameworks to support crowdfunding while safeguarding investor interests.

The SEC in the United States emphasized that crowdfunding provisions under the JOBS Act aimed to provide startups and small businesses with capital through low-cost securities offerings.

Similarly, ASIC in Australia introduced amendments to the 2017 Corporations Amendment Act to create a legislative framework enabling flexible and low-cost access to capital for small to medium-sized unlisted companies while ensuring adequate protections for retail investors.

The European Commission recognized the need for a special regulation for European crowdfunding service providers, noting that existing capital markets rules in the EU might be disproportionate for small activities.

Regulators in developed and emerging economies are customizing regulatory treatments for investment-based crowdfunding, either by introducing specific crowdfunding exemptions or standalone crowdfunding regulations. Several countries have introduced crowdfunding-specific rules, such as Brazil’s Instruction 588665, Mexico’s Financial Technology Institutions Law, Malaysia’s Guidelines on Recognized Markets, and Dubai Financial Services Authority’s Rulebook.

Source: <https://openknowledge.worldbank.org/bitstream/handle/10986/35699/Consumer-Risks-in-Fintech-New-Manifestations-of-Consumer-Risks-and-Emerging-Regulatory-Approaches-Policy-Research-Paper.pdf?sequence=1&isAllowed=y>

Note: ASIC = Australian Securities and Investments Commission; SEC = Securities and Exchange Commission.

TABLE 6: Consumer Risks and Regulatory Approaches: Investment-Based Crowdfunding

RISKS TO CONSUMERS	REGULATORY APPROACHES
<p>Investor inexperience and higher-risk nature of investee companies</p> <ul style="list-style-type: none"> • Small business and start-up investee companies may constitute a riskier investment for retail investors • Investors are often unlikely to possess sufficient knowledge or experience, or lack access to financial advice, to assess offers • Investees may have majority shareholder and management arrangements that present risks for minority shareholders such as external crowdfunding investors 	<ul style="list-style-type: none"> • Require risk warnings and disclosures about key aspects of crowdfunding • Impose issuer caps—limitations on the size of an issue • Impose investor caps—limitations on individual investments/exposures • Require investor-suitability assessments to be undertaken by platform operators • Establish cooling-off periods for investors
<p>Risks relating to the nature of securities offered on crowdfunding platforms</p> <ul style="list-style-type: none"> • Securities rarely traded on any kind of organized market and may have limitations on transferability—investors may not understand or are unable to deal with risk of being unable to exit their investment • Creation of complex hybrid securities by incorporating rights and restrictions for security holders to match issuer's needs 	<ul style="list-style-type: none"> • Prescribe disclosure requirements focused on emphasizing the illiquid nature of issued securities • Restrict the types of securities that can be issued • Impose targeted product intervention • Require targeted warnings • Introduce rules facilitating information exchanges and secondary trading
<p>Consumers are not provided with adequate information</p> <ul style="list-style-type: none"> • Crowdfunding issuers often tend to be small businesses or in their start-up phase with a limited track record, limiting the availability of information • High separation between ownership by crowdfunding investors and parties that control issuers—potential lack of information provided to crowdfunding investors • Retail investors in crowdfunding securities are also at risk of misleading marketing practices, potentially exacerbated as a result of issuers being new to making public offers 	<ul style="list-style-type: none"> • Introduce investment-related disclosure requirements • Introduce regulation of bulletin boards and crowdfunding trading facilities (including secondary market) to assist information accuracy • Apply fair marketing rules to investment-based crowdfunding activities
<p>Platform operator misconduct or failure</p> <ul style="list-style-type: none"> • Platform operators and related parties may engage in misconduct under a range of circumstances that affect investors, from outright fraud to incompetent administration to undertaking unfair conflicted behavior • Failure of a platform can leave investors without services essential to the continued integrity of their investment 	<ul style="list-style-type: none"> • Introduce authorization and vetting requirements • Require business/service-continuity arrangements • Require segregation of client funds • Apply management requirements of the kinds summarized above in the context of P2PL
<p>Issuer fraud: Consumers investing on crowdfunding platforms may suffer losses due to issuer fraud, such as sham offers or concealing or providing misleading information</p>	<ul style="list-style-type: none"> • Require platform operators to undertake due diligence

Source: Consumer Risks in Fintech: New Manifestations of Consumer Risks and Emerging Regulatory Approaches, World Bank

remains only partially realized. The Third International Conference on Financing for Development highlighted the need to ease movement throughout the financial system to enhance migrants' positive contribution to their countries of origin. Crowdfunding, widely implemented globally and within diaspora communities, holds potential to amplify migrants' impact and foster stronger ties between home countries and diaspora communities.

By utilizing P2P lending or investment-based crowdfunding platforms, the diaspora's impact on Lao PDR's development could potentially be magnified, leveraging technology for sustainable growth. These platforms

already offer viable opportunities. To maximize the development potential of private transfers, authorities could implement investment programs attracting migrants' remittances into the MSME sector, possibly with a matching funds scheme from the government and donors. Additionally, a robust marketing campaign abroad, coupled with careful selection of investment-ready companies, could attract diaspora funds for MSME finance. Measures such as removing VAT on remittance transfers and establishing a one-stop shop for diaspora investors, guiding them through business establishment procedures, could further facilitate investment. Coordination among ministries would be essential for this initiative's success.

VI. CREDIT INFRASTRUCTURE²⁷

A. CREDIT REPORTING

Credit information systems are an important tool for effective and efficient credit risk assessment. The primary objective of a credit information system is to reduce information asymmetries between a borrower and lender. This is beneficial in the credit assessment process and thus facilitates access to finance for individuals and MSMEs. The reliability and accuracy of the data collected is crucial for a well-functioning credit information system. Measures thus need to be established to ensure data quality and timely and systematic collection and dissemination thereof. Further, adequate consumer protections need to be in place to ensure privacy and correct usage of information.

In 2019, the BOL upgraded the Credit Information system by establishing the Credit Information Company (CIC).²⁸ Acting as a platform for credit and finance information, CIC enhances coverage and depth by incorporating data from utilities and telecommunication companies. It has secured MOUs with six public agencies and five utility firms to access individual and legal entity information. Currently owned by BOL, CIC envisions potential future joint ventures with financial institutions and the Lao Government. With a minimum required registered capital of KIP 20 billion (approx. USD 2.3 million), CIC generates revenue from credit information service charges, interest income, and other legal sources. Notably, CIC has made significant strides in infrastructure development, data expansion, and service provision. As of March 2024, it boasts 232 members, including 39 banks, 190 financial institutions, and 3 non-financial institutions. In June 2022, CIC introduced two new products for members: utility usage (electricity) and individual credit scoring. While integration of electricity usage and bill payment data into the CIB database is complete, water usage data collection is ongoing. Future plans include the integration of bill payment of postpaid mobile phone subscriptions (ETL and Best Telecom signed-up²⁹). With ongoing credit data integration and scoring system development, CIC anticipates increased coverage and depth of credit information, benefiting over one million individuals and 20,000 enterprises, equivalent to approximately 22 percent of the adult population and 10 percent of registered enterprises.

27. This chapter is intended to provide a general brief overview of key issues regarding the existing Lao PDR regime on credit reporting, secured transactions, and insolvency reforms, rather than a comprehensive analysis.

28. Website: www.lcic.com.la.

29. However, both largest Mobile Network Operators Lao Telecom and Unitel, still refuse to share customer information.

A notable challenge is the need to enhance the frequency of the reporting by member FSPs, which currently occurs monthly. This frequency proves inadequate in preventing simultaneous loan applications to multiple FSPs by the same person or company. According to CIC's management, only 4-5 member FSPs possess the technical capabilities to provide real-time data to CIC, while the remainder rely on cumbersome Excel sheets. This reliance is primarily due to difficulties in their Core Banking Systems' managing information in Lao script.³⁰ Additionally, maintaining data quality poses an ongoing concern, exacerbated by constant staff turnover at FSPs, necessitating regular training sessions.

The adoption of value-added services by FSP members remains limited, with only approximately 100 requests for credit scoring received per month, compared with over 20,000 credit reports queried monthly. Additionally, CIC has not yet explored differentiated pricing strategies, such as offering varied pricing for company credit reports based on the size of the company.

Some FSP members interviewed expressed challenges in finding a match in the CIC database for individuals. A bank had also raised concerns about the lack of information on company representatives, which hinders their ability to identify repeated fraudsters who establish new companies to access loans before driving them into bankruptcy and restarting the process.

B. SECURED TRANSACTIONS AND COLLATERAL REGISTRY

Lack of suitable collateral limits access to finance. Financial institutions typically rely on fixed assets as collateral, whereas MSME assets typically comprise of movable assets. This asset mismatch can be addressed through a secured transactions regime which allows for the creation of a legal framework which facilitate the use of movable assets as collateral. Movable collateral registries have been shown to increase access to bank finance and bank loans respectively, with benefits skewed towards smaller firms. A decline in interest rates and the extension of loan maturity has also been observed in countries in which collateral reform has been introduced.

Lao PDR enacted the Civil Code No. 55/NA dated 6 December 2018, which took effect in May 2020. Part VII of the Civil Code (Articles 510 to 564) replaced most of the provisions of the Secured Transactions Law No. 06/NA dated 20 May 2005. The Decree on the Implementation

30. Name of borrower must be provided in both Roman and Lao scripts.

of the Law on Secured Transactions No. 178/PM dated 20 June 2011, which provides guidelines on the performance of security and enforcement based on the Secured Transactions Law, remains in effect. No separate implementation guideline has been issued.

Although the Civil Code provides some clarity on the creation of security interests and perfection procedures, it does not provide a comprehensive set of rules that adequately deals with all aspects of modern secured transactions, in contrast to international best practices and the UNCITRAL Model Law on Secured Transactions (2016), which exhaustively deals with security interests in all types of tangible and intangible movable property. The Civil Code does not provide specific rules for several aspects, such as what limitations can be imposed by way of contractual arrangements, the treatment of the rights of a judgement creditor vis-à-vis a secured creditor, enforcement of security rights, rules regarding cross-border guarantees, among others. In addition, the priority ranking of state dues over secured creditors' interests from the sale of the collateral is not in accordance with international best practice.

The movable assets registry³¹ was setup in 2013 with technical assistance from IFC and is managed by the Department of State Assets Management at the Ministry of Finance. The registry system was upgraded in 2020 with funding collected from the registration fee. Over thirty companies are using this registry, mostly banks, leasing companies, and law firms (records doubled in 2023 and value of pledges 19-fold!), and occasionally MFIs. Of its 24 users in 2023, there were 6 leasing companies (all foreign-owned), 14 banks and 4 law firms. The activity observed spanned over 2022 to 2024: a 20 percent decline was recorded in 2023 vs. the peak of 12,000+ entries in 2022.

The fee of 20,000 kip regardless of the value of the asset to be registered may put-off its use for more common assets: no consumer electronics, computers, smartphones were ever recorded throughout 2022. 99 percent of assets recorded in 2022 and 2023 were vehicles, almost all by leasing companies, but in 2023 the aggregated value of pledges registered by bank overtook the pledges recorded by leasing companies. Other types of assets, machinery and inventory are almost inexistant in number and value, except among large enterprises: the value pledged skyrocketed in 2023, but on the back of few EDL and large hydro-power contracts. Inventory recording is negligible, with only 6 entries in 2022 and 1 in 2023.

C. INSOLVENCY AND DEBTOR/CREDITOR RIGHTS

A modern insolvency regime has numerous benefits for MSMEs. The clear and predictable insolvency process provided increases lender confidence with respect to recovery of defaulted loans, consequently allowing increased credit. It also allows for timely and effective exit mechanisms for debtors and provides for credible restructuring schemes. assets.

Lao PDR took steps to modernize its bankruptcy regime with the enactment of the revised Law on Rehabilitation and Bankruptcy of Enterprises (the Bankruptcy Law) in early 2020. This revision introduced various reforms, including provisions on MSME insolvency (fast-track) and the appointment of insolvency administrators. Following the law's promulgation, 28 insolvency administrators were officially appointed by the Ministry of Justice, and insolvency judges underwent training. Additionally, the People's Supreme Court developed insolvency Court Forms, and the Ministry of Justice issued regulations on insolvency administrator. However, despite these efforts, there have been no officially reported cases involving judicial reorganization, liquidation, or bankruptcy. The slow implementation of the revised is primarily attributed to the weak capacity of judicial institutions and limited understanding of the benefits of insolvency proceedings among stakeholders.

In practice, several bankruptcy cases may have occurred, but they have been filed as normal commercial cases to be resolved through conventional commercial court litigation, according to the concerned authorities. However, this judicial process can prove cumbersome and costly for private sector, particularly for MSMEs. Secured creditors often encounter difficulties in enforcing collateral in cases of loan default, requiring them to go to court to seek judicial enforcement to protect their rights against debtors. The current court process is lengthy and unpredictable, adversely affecting the efficiency of collateral enforcement. This poses a key risk for banks lending to MSMEs, as delayed debt recovery disincentivizes MSME lending unless another risk mitigation measure is in place, such as higher interest rates, increased collateral requirements, government interest rate subsidies, or credit guarantees.

To circumvent the prolonged judicial process, anecdotal evidence suggests that creditors have turned to alternative dispute resolution methods like mediation or arbitration, which offer faster and less costly resolution of debt disputes. Lao PDR has established the Center for Economic Dispute Resolution (CEDR) and the Office of Economic

31. Website: https://www.mof.gov.la/str/en_index.html

Dispute Resolution (OEDR) as mediation or arbitration centers for commercial disputes, with 246 licensed mediators by 2022. While no arbitrator has been appointed yet, the revised Law on Economic Dispute Resolution (2018) permits the establishment of private economic dispute resolution offices to provide mediation service for businesses, supported by the issuance of the Decree on Private Economic Dispute Resolution Office in 2022.

Furthermore, it is advisable to conduct a targeted awareness campaign among MSMEs about the new bankruptcy law, which remains underutilized, and to provide training for the private and financial sectors on negotiating restructurings under the new regime. Additionally, the team may consider recommending the introduction of a personal insolvency regime with appropriate debt discharge provisions for individuals acting in good faith, a measure already adopted by economies such as China.

VII. GOVERNMENT POLICIES & PROGRAMS IN SUPPORT OF MSME FINANCE

A. GOVERNMENT STRATEGIES AND POLICIES

The GoL is prioritizing measures to bolster MSMEs, recognizing their vital role in employment and economic growth. Under Output 4 of the 9th National Social Economic Development Plan (NSEDP) 2021–2025, efforts are directed towards enhancing the quality and competitiveness of MSMEs, particularly through supply chain integration. The objective is to foster ties between MSMEs and larger companies, both domestically and internationally. Emphasizing greater access to finance and capacity-building services is identified as a key priority within this framework.

Under the NSEDP, the Government has introduced the MSME Development Plan 2021–2025, which marks a significant shift by including micro-enterprises for the first time. This decision follows the findings of the 3rd economic census, revealing that 90 percent of formal enterprises employ five or fewer individuals. However, the assessment of the 2016–2020 phase outlines various programs in private sector development without detailing statistics on MSME support or outcomes. Additionally, it lacks data on MSME segmentation, employment share, and contribution to GDP.

The 2021–2025 Plan draws from lessons learned during the previous phase (2016–2020), emphasizing greater reliance on the private sector for MSME financing and support, and extending the scope to include micro-enterprises. Recognizing the private sector's agility in responding to

evolving MSME needs, the plan aims to leverage it for capacity-building, targeted advisory services, and credit provision. Given the government's constraints in terms of human and financial resources, the plan will concentrate on priority sectors (agriculture, agri-processing, handicrafts, tourism) and areas of support, guided by evaluations of the previous development plan. Notably, Policy #2 'Promoting access to finance' outlines six measures, prioritizing the expansion of the MSME Promotion Fund through blended finance, involving more banks/NBFIs, integrating startup financing, and exploring thematic investment windows for green and socially-oriented enterprises. Alongside the MSME Promotion Fund, initiatives include the introduction of alternative credit products utilizing fintech solutions and capacity-building in accounting and business planning, essential for enhancing MSME lending.

Successful implementation of the plan hinges on several factors. Firstly, robust coordination among key ministries and local authorities is imperative to ensure alignment and synergy across initiatives. Secondly, there is a critical need for better identification and mobilization of funding sources, as well as transparent allocation of funds to priority areas. Thirdly, the plan requires dedicated staff equipped with the necessary skills in policy research, project management, monitoring and evaluation (M&E), and reporting to effectively drive implementation. Furthermore, increasing private sector involvement is essential to leverage their expertise and resources in supporting MSMEs. Finally, an enhanced M&E system is vital to track progress, identify challenges, and make informed adjustments throughout the implementation process.

BOL's National Financial Inclusion Roadmap (2018–2025) aims to enhance economic efficiency and promote growth by advancing financial inclusion, with a primary focus on developing productive credit. This strategy identifies facilitating targeted credit to farmers and productive enterprises, as well as investment in assets, as key outcomes. Priority areas within the first pillar involve reviewing subsidized credit and interest-capping regimes, reducing the reliance on collateral in loan products and application processes by emphasizing estimated incomes and cash-flows, and enhancing MSME credit provision through bank-NBFI linkages, wholesale refinancing, and credit guarantees.

While certain reforms outlined in the National Financial Inclusion Roadmap (NFIR) were indeed implemented, such as the removal of the cap on bank interest rates in 2018, the establishment of a regulatory framework for a guarantee fund in 2020, and the extension of coverage of the Credit Reporting System, there are indications that the NFIR was not actively implemented as intended. There is no mention of regular meetings of an NFIR Steer-

FIGURE 36: Summary of proposed priorities of the Financial Inclusion Roadmap

Vision: Improve household welfare by improving their access to financial services so the access is broad, convenient and deep, meeting the needs for livelihoods development; assist households and enterprises to increase economic efficiency, support for national growth by increased financial inclusion.

Outcomes: Increase general access to financial services among adult population from 75% to 85% by end of 2025; increase access to formal financial services among adult populations from 47% to 52% by end of 2025; increase access to more than one financial product among adult population from 29% to 60% by end of 2025; and increase access to financial services among adult women from 76% to 85% by end of 2025.

1. Improve credit availability	2. Consumer protection	3. Village funds	4. Payments eco-system	5. Financial Outreach
1.1 Credit information	2.1 Improve regulation	3.1 Political support	4.1 Regulatory and policy	5.1 Regulatory and policy
1.2 New credit products	2.2 Financial literacy initiatives	3.2 Regulatory and policy	4.2 Payments infrastructure	5.2 Branch networks of financial institutions
1.3 Reform of subsidised credit	2.3 Financial reporting	3.3 Capacity building	4.3 Mobile money	5.3 MFI expansion
1.4 Review interest rate cap	2.4 Consumer protection			5.4 Product development
1.5 Credit insurance products	2.5 Develop AML-CFT* regulations			5.5 Agents
1.6 MSME support				

*AML/CFT: Anti-Money Laundering/Counteracting Financing for Terrorism

ing Committee or an active secretariat overseeing its implementation. A mid-term evaluation conducted by consultants hired by UNCDF in 2021 highlighted some progress, including those reforms mentioned earlier, but also identified areas lacking action, such as reducing the emphasis on collateral in MSME lending. Despite the Lao government’s commitment to MSME credit provision through the private sector and non-banking financial institutions (NBFIs), it has retained its reliance on subsidized credit without evaluating its impact on employment and enterprise growth.

In addition to initiatives aimed at enhancing MSME access to finance, significant efforts have been made to improve the business environment and foster innovation. These efforts include streamlining business registration processes and embarking on an ambitious program to integrate three separate automated systems – Automated System for Customs Data (ASYCUDA), Lao National Sin-

gle Window (LNSW), and Cross Border Transport Management System (CBTMS)—into a unified National Single Window A+ (NSWA+).

B. GOVERNMENT PROGRAMS

The Government of Laos (GoL) predominantly relies on wholesale lending facilities to promote increased access to finance, with two government funded schemes in BOL and Ministry of Industry and Commerce, and two donor supported schemes (see Table 7). There is also a financially distressed state-owned rural development bank, Nayoby Bank (NBB), with a mandate to provide credit to poverty-alleviation schemes. NBB is reportedly undergoing a restructuring with an aim to improve its performance and profitability. Although limited details have been made public, a key element of the restructuring is to convert the bank into a deposit-taking institution and continue to provide subsidized credit to rural MSMEs.

Authorities should carefully consider the potential financial risks of this approach, consider alternative funding approaches than mobilizing deposits from the public, and aim to incorporate principles of strong corporate governance and professional management in the restructured institution to avoid creating contingent liabilities.

While the donor-funded MSME credit schemes operate on market principles, allowing participating banks to charge market interest rates, the government funded schemes rely on subsidization (or concessional financing) approaches, prioritizing low-interest rate credit to enhance competitiveness. However, this strategy tends to favor an input/output mindset rather than embracing a market-based approach.³² Despite recent efforts to expand finance access by involving non-bank entities in government programs, resource scarcity relative to financing needs has not led policymakers to prioritize outreach and leverage.³³ Providing MSME loans at subsidized rates (0–3 percent p.a., compared to commercial bank rates of 12–14 percent and forecasted inflation above 20 percent throughout 2024) incurs significant costs for the GoL.³⁴ This cost discrepancy is evident when compared to the refinancing cost of GoL kip-denominated debt at 15 percent in September 2023 through BoL bond issuance (interest rate of 20 percent even for BoL bond issuance in June 2022).³⁵ While government programs play a crucial role in engaging the MSME segment, existing interest rate caps restrict the profitability of banks participating in these credit support programs by imposing a maximum interest rate they can charge on loans. When these caps are set below market rates or below what is needed to cover lending risks, banks struggle to generate sufficient returns, discouraging their participation or limiting credit extension to perceived higher-risk segments.

Authorities should consider limiting concessional finance-based programs and instead pursue interventions that prioritize financial additionality and private capital mobilization. As noted above, the subsidized credit programs could distort the market, while producing little additionality. There is also a high fiscal cost to these programs,

which limits their scalability. Meanwhile, there is evidence that programs operating on market terms have succeeded. Under the LAFF program, the main participant ACLEDA caters to MSMEs and charges higher interest rates, underscoring the benefits of a market-driven approach, particularly in a context of fiscal constraints. In terms of interventions with private capital mobilization, under the World Bank financed MSME project, the government is planning to establish a state-owned and licensed partial credit guarantee scheme. While the LCGC is awaiting formal government approval, the proposed entity has been designed to ensure sound corporate governance practices, professional management, and that guarantee decisions are transparent and based purely on commercial principles, and other elements consistent with international best practices (see Box 2). A well-run partial credit guarantee scheme could increase access to finance for MSMEs unable to obtain loans due to insufficient collateral, while leveraging private capital by incentivizing banks to extend credit to MSMEs.

The MSME credit schemes also suffer from cumbersome approval processes and weak monitoring and evaluation frameworks. Disbursement processes encounter delays attributed to administrative requirements and partner FSPs' eligibility criteria, compounded by limited absorption capacity. Substantial resources are dedicated to compliance and reviewing MSME loan applications, often duplicating the underwriting efforts of partner FSPs. This redundancy prolongs disbursement timelines, which can stretch up to 3–6 months, impeding access to funds for needy MSMEs. Furthermore, stringent eligibility criteria for partner FSPs, emphasizing financial performance and transparency to align with international standards, present challenges for the domestic financial industry characterized by under-capitalization and limited capacities. Despite efforts to broaden outreach by involving NDTM-FIs, the MSME Promotion Fund struggles to match LAFF's outreach numbers. Table 8 illustrates this discrepancy, with LAFF's outreach surpassing that of the MSME Promotion Fund by eleven-fold, despite similar disbursement volumes from 2020 to 2023. These challenges highlight the need to consolidate and transition all government-funded programs into an independent fund managed by a new and professionally run Apex institution, to improve governance, transparency, and decision making, in line with international best practices.

None of the programs implement outcome tracking for borrowing MSMEs, such as increased revenues and employment, necessitating a longitudinal survey of borrowing MSMEs. However, the concerned departments cite resource constraints for such surveys after allocating resources to the prior review of MSME borrowers' loan

32. Very often in response to the demands expressed at the National Assembly.

33. Quote from MoL vice-Minister: "Most importantly, outstanding MSME units [who received funding in 2023 and are to be inspected in 2024] that made the best use of funds, as well as the financial institutions engaged in funding those MSMEs, will be selected for 2024,". *Vientiane Times* 22/03/2024, 'Lao MSMEs to receive boost from govt promotion fund'.

34. Lao PDR Economic Monitor, World Bank, April 2024

35. GoL debt refinancing is increasingly channeled through BoL and the domestic banking sector. Compare the interest rate offered on 1-year bond of 5.8% in MoF issuance March 2023, with the 15% p.a. interest on 6-month BoL bonds issued in September 2023 (Sources: Laos News agency <https://kpl.gov.la/EN/detail.aspx?id=72020>, *Vientiane Times* 06 September 2023).

BOX 2**World Bank Principles for Public Credit Guarantee Schemes for SMEs**

Public credit guarantee schemes (CGSs) are a commonly employed government intervention aimed at improving MSME access to finance. A CGS provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans made to SMEs in case of default, typically in return for a fee. More than half of all countries in the world have deployed a CGS to support MSME finance expansion. When well designed, CGS can spur participating banks and non-bank financial institutions grow their MSME portfolio and have positive ecosystem effects by demonstrating the business case for serving previously unreached MSME segments.

When they are not well designed or implemented, CGSs can be costly, inefficient, and provide limited benefits. Based on global experiences in design, implementation, and evaluation of public CGSs to improve access to finance for SMEs, CGS guiding principles were developed by the World Bank Group in coordination with the SME Finance Forum.

16 principles cover four key areas that are critical for the success of CGSs:

Legal and regulatory framework

1. Establish the CGS as an independent legal entity.
2. Provide adequate funding and keep sources transparent.
3. Promote mixed ownership and treat minority shareholders fairly.
4. Supervise the CGS independently and effectively.

Corporate governance and risk management

5. Clearly define the CGS mandate.
6. Set a sound corporate governance structure with an independent board of directors.
7. Design a sound internal control framework to safeguard the operational integrity.
8. Adopt an effective and comprehensive enterprise risk management framework.

Operational framework

9. Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments.
10. Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability.
11. Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.
12. Set a transparent and consistent risk-based pricing policy.
13. Design an efficient, clearly documented, and transparent claim management process.

Monitoring and evaluation

14. Set rigorous financial reporting requirements and externally audit financial statements
15. Publicly disclose non-financial information periodically.
16. Systematically evaluate the CGS' performance and publicly disclose the findings.

Source: World Bank

applications. This lack of longitudinal follow-up impedes the gathering of lessons learned. A one-off survey of MSME Promotion Fund credit recipients revealed that half of beneficiary MSMEs had not taken any loans in the past 10 years, indicating the scheme's additionality. However, staffing increased on average by only 4.3 percent pre-COVID, falling below the target of a 10 percent average staff increase. The loan application process did not seem

too cumbersome for PFIs and beneficiary MSMEs, except for the Environmental & Social Assessment.

While technical assistance is extended to partner FSPs, MSMEs receive inadequate capacity-building support, resulting in indiscriminate deployment and a lack of outcome tracking. The MSME Promotion Fund provides comprehensive technical assistance through training ses-

sions at SME Service Centers and BDS Providers, primarily targeting access to finance, business planning, and accounting skills. However, there is a noticeable absence of earmarked assistance for borrowing MSMEs.

Three-fourths of LAFF's refinancing to banks originate from ACLEDA, which opposes providing differentiated terms to its clients based on their participation in a public lending scheme. The higher interest rates imposed by ACLEDA don't deter numerous local entrepreneurs and underscore the benefits of a market-driven approach, particularly in a context of fiscal constraints.

The SME Promotion Fund has reportedly received an annual contribution from the Government of Laos (GoL) ranging from 100 to 200 billion kip since 2020. This suggests a disbursement rate of just 63% of the committed budget. Although the LAFF capital utilization rate is not disclosed, the infrequent calls for Expression of Interest (EOI)—only one each year in 2020, 2021, and 2023, and none since January 2023—suggest that some LAFF capital may remain idle due to weak demand from FSPs, likely resulting from unattractive terms.

TABLE 7: Comparison of the different GoL public MSME lending schemes

	SME PROMOTION FUND (GoL FUNDS)	MSME A2F ESR	LAFF³⁶	BoL GoL WINDOW³⁷	NBB³⁸
Source of funds	GoL	World Bank	€12 million KfW grant to GoL		GoL exclusively
Administration	MSME Promotion Agency (spun-off from MoIC)	MSME Promotion Agency	BoL/BOD	BoL/BOD	NBB
Eligible MSMEs	Formal MoIC registration. Prior review of all MSME loan applications Agriculture & livestock; agro-processing; handicraft; tourism.	Formal MoIC registration. Prior review of all MSME loan applications	Formal & informal MSMEs. Excluding the 4 urban districts of Vientiane Capital	Formal MoIC registration. Prior review of all MSME loan applications	Formal & informal MSMEs. Located in the 68 districts classified as 'poor' by GoL ³⁹
Eligible FSPs	Commercial banks	Commercial banks,	Commercial banks, DTMFIs. Meet ceiling for NPL<5%, CAR>12%	Commercial banks	N/A (only direct lending)
Interest rate (p.a.) applicable to borrowing MSME	3%	emergency phase: 6.5% Recovery phase: market rate	Market rate: as per partner FSP's own policy	5.5%	5% loans ≤1 year 6% loans 1-5 years 7% loans >5 years
MSME loan size	Micro ≤1.5 billion small ≤3 billion medium ≤4 billion	Loan size≤1.6 billion	Size 2-500 million kip		
MSME loan duration	WC: Up to 5 yrs Investment: up to 10yrs	Up to 9 years (1 year grace period)	Tenure ≥1.5 year		
Wholesale refinancing rate (p.a.)	0%	6.8%	Market rates benchmarking Term Deposits rates: 5.9% Banks 7.5% DTMFIs		N/A
Wholesale refinancing terms			6 years for banks 4–6 years for DTMFIs. Principal grace period 1/3 of tenure		N/A
Particularities			ACLEDA is the main borrower (declined to participate in other schemes)		Group guarantee substituting to collateral

36. Source: Call for Expression of Interest LAFF dated 18 January 2023, available on <https://laff.org.la/> and BoL website www.bol.gov.la.

37. Official name: Credit Project for Supporting Domestic Production and Mitigating the Impact of COVID-19 (No.318/BOL, dated 19 May 2020)

38. Website: www.nbb.com.la. NBB was founded in 2007 with a split of the loan portfolio for rural development held at APB. NBB is completely modeled after the Vietnamese Bank for Social Policies (VBSP). NBB disbursed 2,463 billion kip credit in 2019 (see GoL report to the 2019 Round Table Meeting) in credit overall: the share of MSME credit is not disclosed.

39. 68 'poor' priority districts listed by PM Decree Poverty Reduction [reference & date]

TABLE 8: Compared refinancing activity of LAFF and SME Promotion Fund

FSPS CATEGORY OF THE BORROWER	LAFF			MSME PROMOTION FUND		
	amount in billion kip	Number of loans	% NPL end 2023	amount in billion kip	Number of loans	% NPL end 2023
Banks	371	11,299	0.04%	476	361	
Medium-sized*	0	0		276	158	
Small-sized*	371	11,177		191	187	0.40%
Micro companies*	0	122		9	16	
Other unclassified *	0	0		0	0	
Deposit-Taking MFIs	165	10,714	0.54%	11	473	
Medium-sized*	0	0		0	0	
Small-sized*	0	0		0	0	
Micro companies*	165	10,714		11	473	
Other unclassified *	0	0		0	0	
Non-Deposit-Taking MFIs				18	1,106	
Medium-sized*				0	0	
Small-sized*				0	0	
Micro companies*				18	1,106	
Other unclassified *				0	0	
Total across FSPs	536	22,013	0.19%	505	1,940	
Medium-sized*	0	0		276	158	
Small-sized*	371	11,177		191	187	
Micro companies*	165	10,836		38	1,595	
Other unclassified *	0	0		0	0	

*Classification of borrowing companies' size according to the internal definitions of each Participating Financial Institution may not fully align with the GoLs updated definition as per Decree No.04/GOL/2023. Refer to § IV.A. for discussion on the absence of comprehensive guidance for accurately classifying MSMEs by size.

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APPENDICES

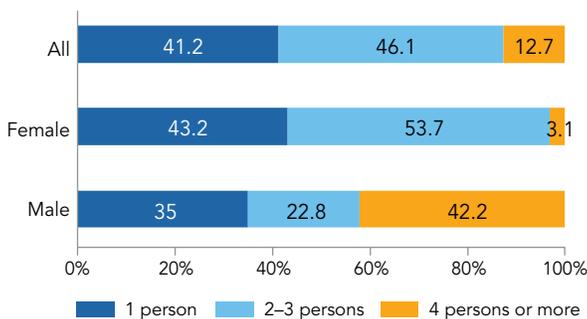
A. INFORMAL FIRMS AND AGRICULTURAL MICROENTREPRENEURS

A limitation of the World Bank Enterprise Survey is its focus solely on non-micro, formal firms registered with the government, excluding insights into the informal sector and the micro sector – a significant segment of MSMEs. To address this gap, the World Bank conducted the Lao PDR Informal Sector Business Survey (ISBS) in 2019, gathering information on non-agricultural informal firms. However, it is important to note, that the ISBS is representative only of Vientiane and Pakse, limiting its generalizability to the

broader informal sector landscape in Laos. Nonetheless, this appendix offers valuable insights into the characteristics of Lao informal firms and their reliance on financial products.

In the informal sector, firms are predominantly small-scale. On average, 41 percent of informal businesses operate with just one-person, while only 12.7 percent have four or more workers. Notably, as Figure 38 shows, informal firms owned by men tend to be larger. While only 3 percent of female-owned informal businesses have four or more workers, 42 percent of informal, male-owned firms employ at least 4 people.

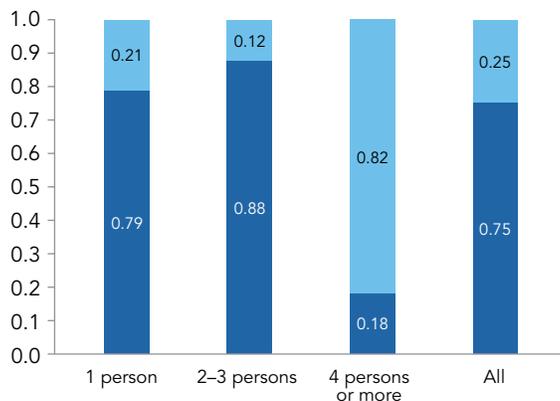
FIGURE 37: Firm size



Source: 2019 Laos Informal Sector Business Survey.

Notes: The figure plots the distribution by size of informal firms, as well as female-owned and male-owned informal firms. Female-owned firms are classified as firms that report that at least one of the owners is a woman. Firms that belong to the agricultural sector are not covered in the sample.

FIGURE 38: Gender of owner



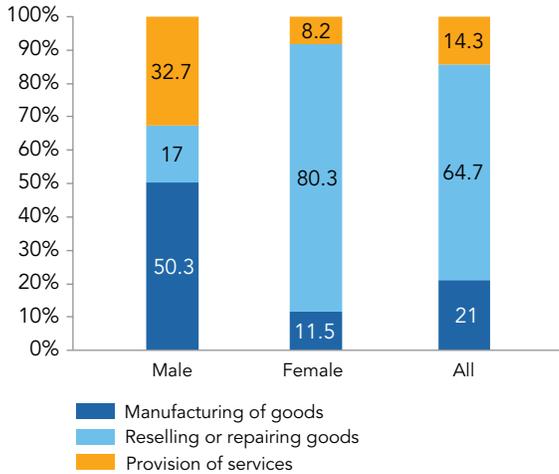
Source: 2019 Laos Informal Sector Business Survey.

Notes: The figure plots the share of informal firms by the gender of their owner. Female-owned firms are classified as firms that report that at least one of the owners is a woman.

Among the smallest informal firms, 79 percent are owned by at least one woman, while 21 percent are exclusively owned by men. This trend persists for firms operated by 2 to 3 persons. Conversely, the largest informal firms,

employing 4 or more people, are predominantly owned by men, with only 18 percent having a woman as a partial or full owner.

FIGURE 39: Distribution of activities of informal firms



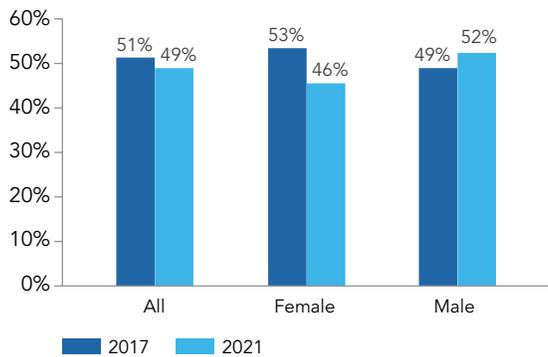
Source: 2019 Laos Informal Sector Business Survey.
 Notes: The figure plots the distribution of activities of informal firms. Distributions are displayed for all informal firms and for female and male owned informal firms.

Non-agricultural informal firms concentrate their activities in three main areas: manufacturing goods, reselling or repairing goods, and providing multiple services. There are large gender differences in the activity of these informal firms. For instance, 50 percent of male-owned informal firms falls in manufacturing, mostly consisting of manufacturing household items, clothes, or shoes. In turn, 80 percent of women-owned firms sell or repair goods, with selling food being the most popular activity of female-owned firms.

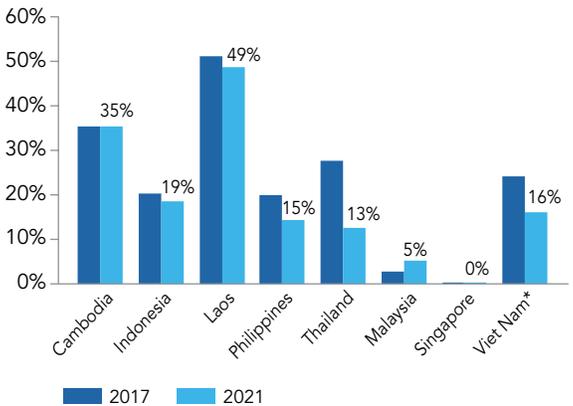
Index data sheds light on the characteristics of agricultural firms, primarily family-owned, in Lao PDR. A significant portion of the adult population, approximately half, receives payments for agricultural products, livestock, or crops (Panel A of Figure 40). From 2017 to 2021, the percentage of women reporting such payments decreased from 53 to 46 percent, while for men, it increased from 49 to 52 percent. Lao PDR stands out when comparing the share of adults engaged in agricultural businesses with other countries in the region (Panel B).

FIGURE 40: Share of individuals that receive payments for the sale of agricultural products

A. By gender, in Lao PDR



B. Regional comparison



Source: Global Findex Dataset.
 Notes: The figures plot the percentage of adults (15 and older) that received payments for the sale of agricultural products, livestock, or crops in 2017 and 2021 (years with information available for Lao PDR). Panel A displays the percentage of all adults, as well as of female and male adults. Panel B plots the percentage of all adults across peer countries in the region.
 *For Vietnam, the data of 2021 was not collected, and the number reported corresponds to the indicator gathered in 2022.

B. ACCESS TO FINANCIAL PRODUCTS BY INFORMAL FIRMS

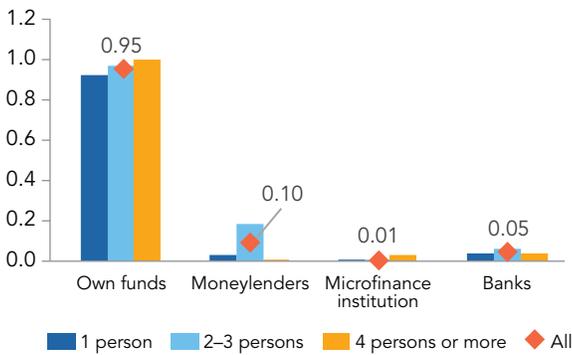
The 2019 Informal Sector Business Survey (ISBS) sheds light on the financial dynamics of non-agricultural informal firms in Lao PDR, focusing on urban areas like Vientiane and Pakse. Despite its urban-centric scope, the survey reveals a striking trend: informal firms demonstrate minimal dependence on formal financing for daily operations and asset acquisitions. Typically, over 90 percent of these businesses rely on internal funds, with external financing

predominantly sourced from moneylenders. Notably, banks and microfinance institutions have limited involvement in financing informal enterprises.

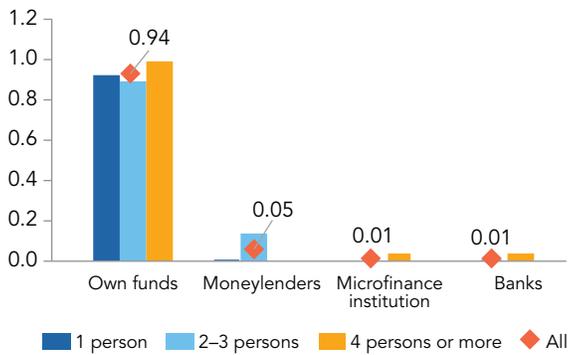
Supply chain credit, such as credit from suppliers or advanced payments from customers, is not widely reported among informal firms, with only 17 percent reporting this type of financing in the last year. However, there is an interesting financing mismatch: a majority of these informal businesses (60 percent) extend credit to their clients when selling goods or services.

FIGURE 41: Financing of informal firms' activities

A. Financing sources of day-to-day operations



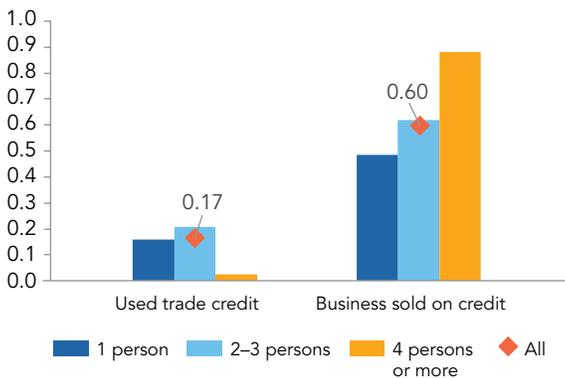
B. Financing sources of fixed assets



Source: 2019 Laos Informal Sector Business Survey.

Notes: The figures plot the share of informal firms reporting using different financing options to pay for their day-to-day operations (Panel A) and their fixed assets (Panel B). All firms report the information summarized in Panel A. The information summarized in Panel B is only asked to firms that purchased fixed assets in the last 3 years, which consist of 30 percent of firms. The shares are displayed for all informal firms (yellow diamonds) and for each size category.

FIGURE 42: Credit to informal firms and their buyers

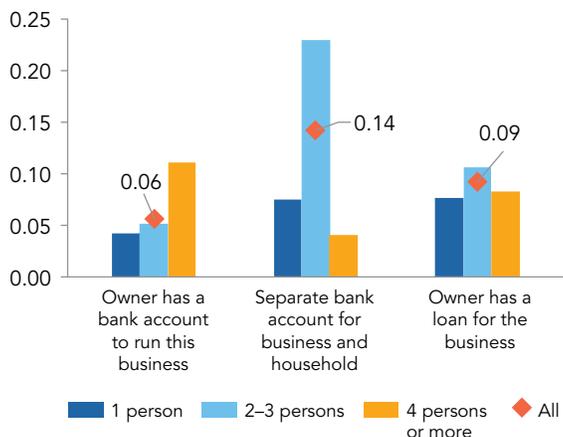


Source: 2019 Laos Informal Sector Business Survey.

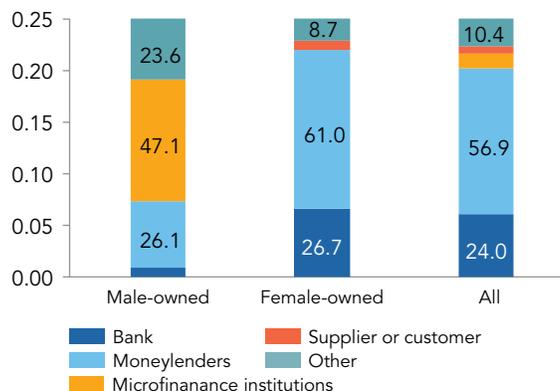
Notes: The figure plots the share of informal firms that used trade credit (defined as buying inputs, goods or supplies on credit, or receiving advances from customers in the last year) and that sold on credit (defined as sell goods or services on credit in the last year). Shares are displayed for all informal firms and by the size of firms.

FIGURE 43: Financial products of the business

A. Financial products of the business



B. Lenders of the most recent loan



Source: 2019 Laos Informal Sector Business Survey.

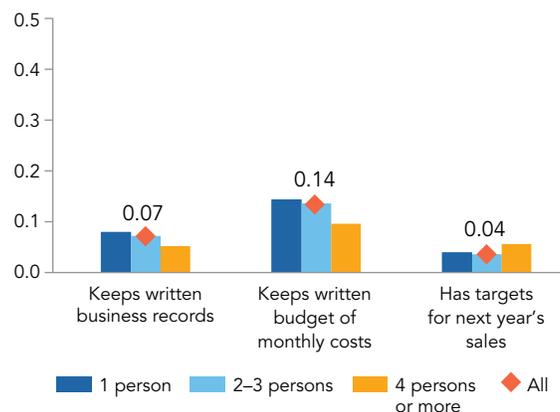
Notes: The figure plots the share of informal firms that have a bank account, that keep the account separate from the household (for firms that have an account), and that have a loan for the business. The shares are displayed for all informal firms (red diamonds) and for each size category.

Panel A of Figure 43 reveals the limited utilization of formal financing products among informal firms, with only 6 percent having a dedicated bank account for business operations. Moreover, among those with a bank account, just 14 percent maintain a separate account from their household finances. Regarding credit, less than 10 percent of informal firms have an outstanding loan to support their operations. In Panel B, it is evident that moneylenders are the predominant source of the latest credit obtained by female-owned firms, while microfinance institutions are more prevalent among male-owned firms.

Informality exacerbates challenges in accessing finance. The ISBS survey highlights that informal firms exhibit poorer business practices and managerial capacity compared to formal firms. As depicted in Figure 44, on average, only 7 percent of informal firms maintain written business records, 14 percent keep a written budget detailing the monthly costs, and just 4 percent set targets for sales following year. Given that low managerial capacity and poor business practices correlate with reduced productivity (Bruhn et al., 2018), informal firms appear less efficient compared to registered Lao enterprises, thereby heightening the difficulty of accessing finance.

However, transitioning to formal status holds little appeal for informal firms. Panel A of Figure 45 shows that, on average, only 8 percent of informal firms have considered

FIGURE 44: Business practices of informal firms



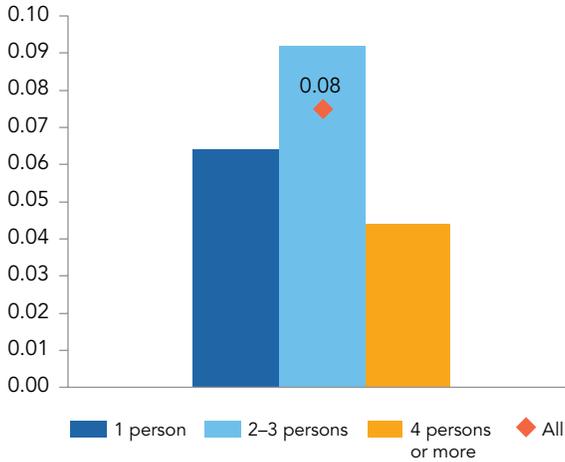
Source: 2019 Laos Informal Sector Business Survey.

Notes: The figure plots the share of informal firms that keep written business records, that keep written budgets of their monthly costs, and that have targets for their sales in the next year. The shares are displayed for all informal firms (red diamonds) and for each size category.

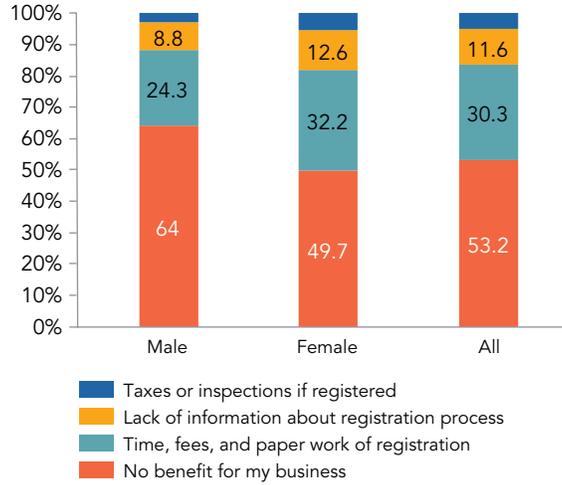
registering their business in the past. Even among the largest informal firms, where the potential benefits of formalization might be the most pronounced, less than 5 percent have contemplated it. The primary deterrent for not registering is the perceived lack of benefits associated with formalization. Taxes and inspections, are cited by fewer than 5 percent of firms as the main reason for not registering (Panel B of Figure 45).

FIGURE 45: Staying informal

A. Informal firms that considered registering their business



B. Reasons to stay informal



Source: 2019 Laos Informal Sector Business Survey.

Notes: Panel A plots the share of informal firms that have considered registering their business in the past. The shares are displayed for all informal firms (red diamond) and for each size category. Panel B plots the distribution of main reasons for not registering, displayed for all

C. ACCESS TO FINANCIAL PRODUCTS BY AGRICULTURAL MICROENTREPRENEURS

Although there is a lack of detailed data on agricultural firms operating in Laos, it is widely recognized that a significant portion of these enterprises operate informally and are family-owned (World Bank Group, 2023; GOPA, 2020). To address this gap, this note utilizes Findex data to offer insights into the financial products accessed and utilized by adults who report receiving payments for the sale of agricultural products, referred to in this note as *agricultural microentrepreneurs*.⁴⁰

Given the prevalence of agricultural engagement in the Lao work force, where more than half of the adult population receives payments from the sale of agricultural products, it’s important to understand whether these businesses rely on formal financial products. Findex data examines the means of payment used for these sales. As depicted in Figure 46, cash remains overwhelmingly dominant for agricultural entrepreneurs in the country, with minimal progress observed over time. In 2017, only 4 percent of agricultural entrepreneurs received payments through financial institutions, mobile phones, or cards, which increased marginally to 6 percent four years later. Comparatively, cash is also the primary payment method

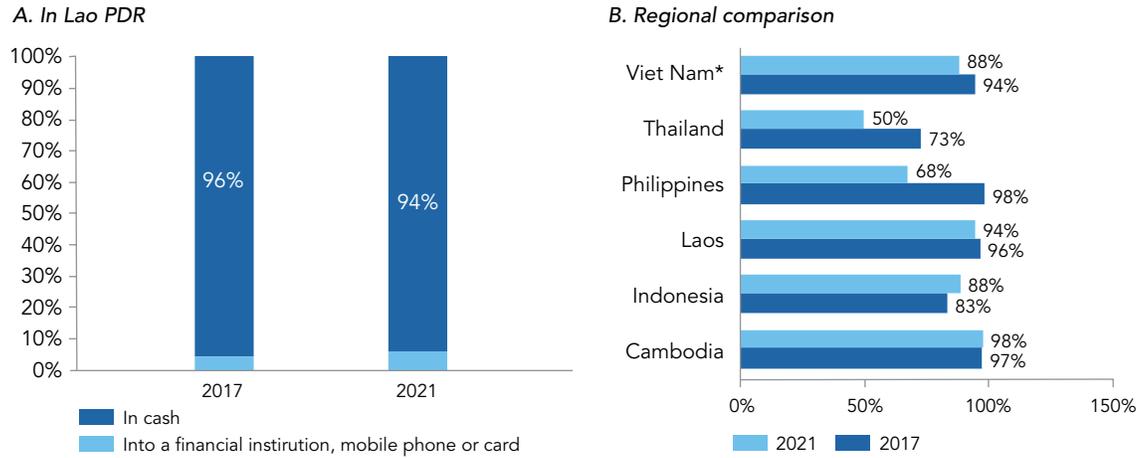
for agricultural sales in peer countries, but its usage is less pervasive than in Laos. Panel B illustrates that in 2021, cash payments constituted 98 percent and 94 percent of all agricultural transactions in Cambodia and Laos, respectively. In contrast, countries like Thailand and the Philippines have made significant strides in transitioning agricultural payments away from cash.

Findex data provides insights into the familiarity of agricultural microentrepreneurs in Laos with financial products. One key indicator is the ownership of accounts at financial institutions, which remains low. In 2021, approximately 66 percent of adults involved in agricultural businesses did not possess an account with a bank or other financial institution. This percentage is slightly higher among men than women. Additionally, the usage of debit cards, another basic financial product, is uncommon among adults engaged in agricultural activities. In 2021, less than 5 percent of agricultural entrepreneurs utilized a debit or ATM card.

Despite the low rates of account ownership and usage of debit cards, over half of agricultural microentrepreneurs are actively involved in saving and borrowing. However, a significant portion of those who saved in 2021—42 percent—did so informally, outside of financial institutions regulated by BoL. Similarly, informal sources for borrowing are prevalent among both

40. Detailed information on the Global Findex data is provided in Demirgüç-Kunt, Klapper, Singer and Ansar (2022).

FIGURE 46: Adults paid in cash for their agricultural payments

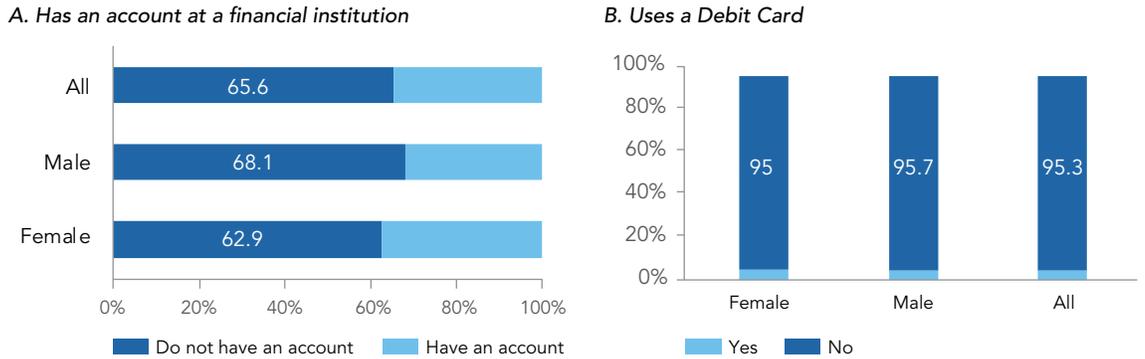


Source: Global Findex Dataset.

Notes: The two panels of the figure show the percentage of adults receiving payments for agricultural products that are paid in cash, or directly into a financial institution account, a mobile phone, or a card. Panel A displays the percentage of all adults in Lao PDR. Panel B plots the percentage of all adults across peer countries in the region.

*For Viet Nam, the data of 2021 was not collected, and the number reported corresponds to the indicator gathered in 2022.

FIGURE 47: Access to financial products by gender



Source: Global Findex Dataset 2021.

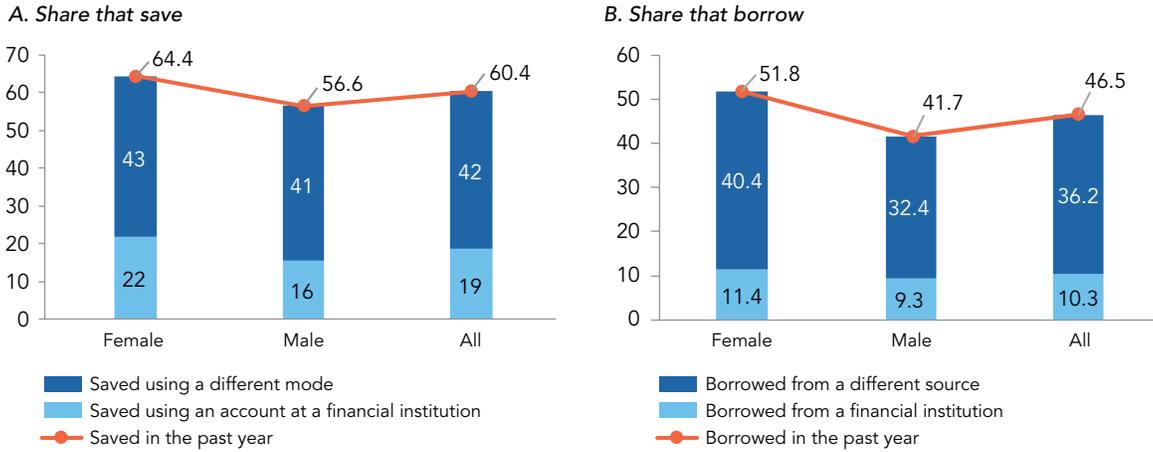
Notes: The figures plot the percentage of agricultural microentrepreneurs who report having an account (by themselves or together with someone else) at a bank or another type of financial institution (Panel A) and that report using a debit or ATM card (Panel B).

women and men in Laos. Of the 46 percent of adults who borrowed in the same year, 36 percent relied on family or friends, while only 10 percent utilized formal financial institutions.

Cash remains the main instrument in agricultural transactions. In Laos, similar to other countries, the pandemic

hastened the adoption of digital payments (see Box 3). However, the proportion of agricultural microentrepreneurs engaging in digital payments remains modest. For instance, approximately 19 percent of them made or received a digital payment in 2021 (Panel A), and less than 10 percent have conducted a digital merchant payment (Panel B).

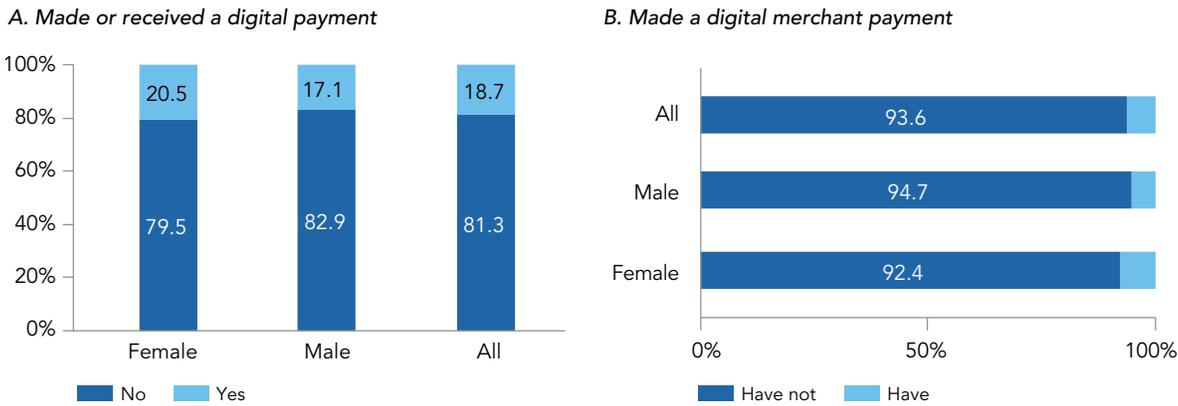
FIGURE 48: Saving and borrowing among agricultural microentrepreneurs



Source: Global Findex Dataset.

Notes: Panel A plots the percentage of agricultural microentrepreneurs who report personally saving in the past year for any reason, as well as the percentage who saved at financial institutions or saved in different modes. Panel B plots the percentage of agricultural microentrepreneurs who report borrowing any money (by themselves or together with someone else) in the past year, as well as the percentage who borrowed, and who borrowed from different sources.

FIGURE 49: Share of agricultural microentrepreneurs making digital payments



Source: Global Findex Dataset.

Notes: The figures plot the percentage of agricultural microentrepreneurs who report using mobile money, a debit or credit card, or a mobile phone to make or receive a payment from/into an account (Panel A) or to make a digital merchant payment (Panel B) in the past year. Data by rural/urban status is only available for 2021.

BOX 3

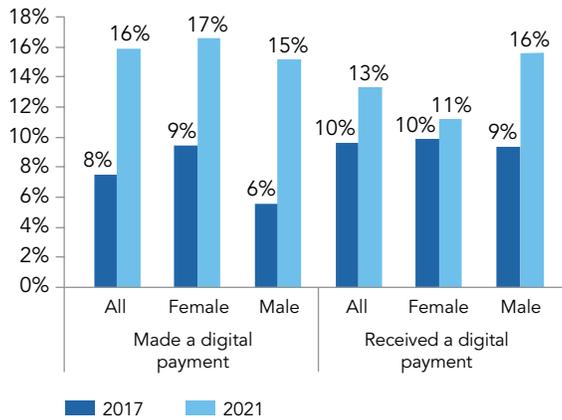
The rise of digital payments

During the years 2017-2021, the percentage of adults making a digital payment increased from 8 to 16 percent. The share of adults that received a digital payment also increased during these years, from 10 to 13 percent. However, most of this increase was concentrated in men, who observed an increase in digital payments received from 9 to 16 percent. The share of adults that received and made payments in rural areas is about three times lower than in urban ones.

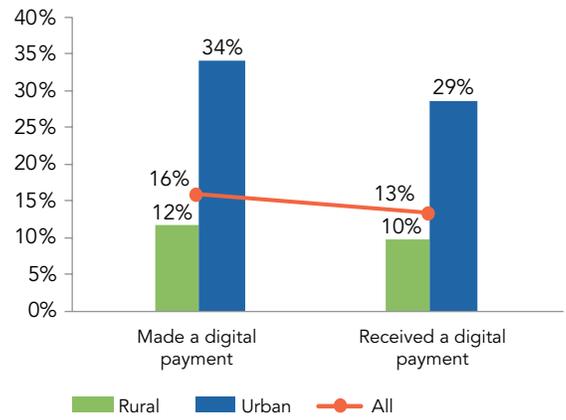
The share of mobile money accounts issued by banks is set to increase further, with supply-side data indicating 1,125,000 active accounts as of October 2023. This would mean that approximately one-fourth of adults have an active mobile money account with a bank. Additionally, QR code payments have become the predominant method in Laos, accounting for 99.9 percent of domestic merchant transactions, effectively sidelining the use of cards. Moreover, the adoption of cardless ATM withdrawals, facilitated by QR codes, is also growing, representing 18 percent of all ATM transactions.

FIGURE 50. Share of individuals making digital payments

A. By gender



B. By rural/urban status (2021)



Source: Global Findex Dataset.

Notes: The figures plot the percentage of adults (15 and older) who report using mobile money, a debit or credit card, or a mobile phone to make or receive a payment from/into an account in the past year. Data by rural/urban status is only available for 2021.

