

# **Operation and Management of the Village Development Fund in Champasak Province, Lao PDR**

**Bounthom Sisoumang, Vute Wangwacharakul<sup>\*</sup> and Visit Limsombunchai**

## ABSTRACT

As a least developed country, the economy of Lao PDR has an agricultural base with a high percentage of poor people living in rural areas. Poverty eradication and rural development are at the center of the government's economic and social development policies. The Village Development Fund (VDF) has been used as an important strategy to increase access by the rural poor to financial capital. This paper reviews the development of the VDF in Champasak province, Lao PDR and assesses its operation and management, especially the structure, management rules, operation, and performance aspects, and is supported by interviews with the VDF management committees of two districts in the province. The results show that the VDF has expanded gradually over the past few years. The management was generally satisfactory. However, main problems encountered related to ethical issues and the good governance of management personnel. Through its policies, the VDF contributes to social development in the villages. This requires not only management skills and experience to optimize business and social goals, but also knowledge and understanding of the members to accept a flexible or relatively moderate rate of return on deposits. The non-performance of loans, as observed, was mostly caused by failures in crops or livestock raising.

Hence, to sustain the VDF in Champasak province, it is important to widen the capacity development by increased campaigning on the basic knowledge of the principles and concepts among the members and on ethical development and good governance among the members of the management and advisory committees. To avoid non-performance of loans, it is essential to reduce the risks from investment in agricultural or non-agricultural activities. This requires more support from the public sector to ensure the efficiency and sustainability of the village development fund.

**Keywords:** operation, management, village development fund, Champasak, Lao PDR

## บทคัดย่อ

ສາທາລະນະລັດ ປະຊາທິປະໄຕ ປະຊາຊົນລາວ ເປັນ  
ປະເທດຍາກຈນ ແລະ ອາຍຸການ ເພື່ອ ດັ່ງກ່າວ  
ເປັນ ລັດ ແລະ ມີສັດ ສ່ວນປະຊາກົດ ທີ່ ຍາກຈນ ສູງ ໂດຍ  
ເລີ່ມຕົວ ໃນ ທະນາທີ ດັ່ງກ່າວ ສ່ວນປະຊາກົດ ແລະ ດັ່ງກ່າວ

พัฒนาชนบทเป็นหนึ่งในนโยบายหลักของรัฐบาล  
ลาวในการพัฒนาเศรษฐกิจและสังคมของประเทศ  
ประเทศลาวได้ใช้กลไกของทุนพัฒนาหมุนเวียนเป็น<sup>1</sup>  
กลยุทธ์ในการเพิ่มความสามารถในการเข้าถึงเงินทุน  
ของคนยากจนในชนบท บทความนี้ได้ทบทวนการ  
ดำเนินงานของกองทุนพัฒนาหมุนเวียนในจังหวัด

จำปาสัก สาธารณรัฐประชาธิปไตยประชาชนลาวเพื่อประเมินการดำเนินงานและการบริหารกองทุนโดยเน้นพำนี้ด้านโครงสร้าง กฎระเบียบ การจัดการและผลของการดำเนินงานโดยใช้ข้อมูลจากการสำรวจและคณะกรรมการกองทุนพัฒนาหมู่บ้านในสองอำเภอของจังหวัดจำปาสัก ผลของการศึกษาพบว่ากองทุนพัฒนาหมู่บ้านได้ขยายตัวอย่างต่อเนื่องในหลายปีที่ผ่านมา การจัดการส่วนใหญ่เป็นที่น่าพอใจอย่างไรก็ตาม มีปัญหาด้านจริยธรรม ธรรมาภิบาลของผู้บริหารในกองทุนที่ต้องระมัดระวัง นอกจากนี้กองทุนพัฒนาหมู่บ้านต้องจัดสรรผลประโยชน์เพื่อการพัฒนาส่วนรวมของหมู่บ้านตามนโยบายของรัฐบาล การบริหารงานกองทุนพัฒนาหมู่บ้านจึงต้องใช้ทักษะในการบริหาร และความชำนาญเพื่อให้เกิดความสมดุลระหว่างผลประโยชน์ในด้านธุรกิจกับด้านสังคม ต้องสร้างความรู้ ความเข้าใจให้กับสมาชิกในการยอมรับอัตราผลตอบแทนที่ดีขึ้นและพอประมาณในการทำธุรกิจกับกองทุนพัฒนาหมู่บ้าน การศึกษาพบว่า หนึ่งสัญของกองทุนพัฒนาหมู่บ้านส่วนใหญ่เกิดจากความล้มเหลวของการปลูกพืชและเดียงดัตต์ว์เนื่องจากภัยธรรมชาติ

ดังนั้น เพื่อให้กองทุนพัฒนาหมู่บ้านในจังหวัดจำปาสักมีความยั่งยืน จำเป็นต้องเพิ่มขีดความสามารถโดยการรณรงค์เพิ่มความรู้ ปรัชญา หลักการ แนวคิดของกองทุนพัฒนาหมู่บ้านให้กับสมาชิก การส่งเสริมจริยธรรมและธรรมาภิบาลของคณะกรรมการและผู้จัดการกองทุนพัฒนาหมู่บ้าน เพื่อลดความเสี่ยงหนึ่งสัญ กองทุนพัฒนาหมู่บ้านต้องลดการส่งเสริมการลงทุนในกิจกรรมการเกษตรหรืออนาคตที่มี

ความเสี่ยงสูง แนวทางเหล่านี้จำเป็นต้องได้รับการสนับสนุนจากภาครัฐเพื่อให้กองทุนพัฒนาหมู่บ้านสามารถพัฒนาต่อไปได้อย่างมีประสิทธิภาพและยั่งยืน

**คำสำคัญ:** การดำเนินงาน การจัดการ กองทุนพัฒนาหมู่บ้าน จำปาสัก สาธารณรัฐประชาธิปไตยประชาชนลาว

## INTRODUCTION

Lao is a poor country with a population of 6.3 million people and contains ethnic groups living throughout the country from the north to the west (Foundation for Development Cooperation, 2010). The country shares borders with China, Myanmar, Thailand, Vietnam, and Cambodia. In 1986, the Lao government adopted a policy to ensure self-sufficiency in food supply and transformed the economy from a centrally planned to a market-oriented one (Latsavong & Biallas, 2007). Despite the increasing contribution of industry and services, agriculture has been the main contributor to the gross domestic product of the country accounting for about one-half of the total (Table 1).

Similar to other developing or least-developed countries, the urban sector in Lao PDR is relatively well developed in both economic and social aspects. The rural households, on the other hand, live in relatively poorly developed areas and rely on rain-fed agriculture and lack other economic opportunities or social support. Many areas are accessible only in the dry season. Hence, a larger proportion of people in rural areas live below the poverty line compared to those in urban areas.

**Table 1** Gross domestic product (GDP) growth in Lao PDR and share by sector, 2002–2010

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total GDP (%)	6.87	6.21	7.02	6.77	8.66	6.83	7.50	7.50	8.10
Agriculture (% of total)	40.29	38.71	36.69	34.38	30.33	31.46	30.47	30.51	28.41
Industry (% of total)	18.38	20.11	19.28	22.03	27.90	26.73	26.23	24.53	25.93
Services (% of total)	35.70	35.52	38.03	37.26	35.29	35.23	36.52	38.73	39.32
Import duties (% of total)	5.62	5.67	6.01	6.32	6.48	6.57	6.78	6.23	6.34

Source: Statistics Department (2011)

The Lao government has emphasized development efforts to improve the living standards and health care, and to enhance the education opportunities of these poor people. The poverty rate has reduced from 33.5 percent in 2002–2003 to 26 percent in 2010 (Table 2).

To address poverty, the Lao government has implemented the National Poverty Eradication Programme aimed at helping the poorest group by improving their basic needs such as health services, primary education, infrastructure, and agricultural products, with the target to improve from the country's least developed country status and meet the Millennium Development Goals by 2020 (Ministry of Planning and Investment, 2011). The government of Lao launched the Village Development Fund (VDF) across the country in the early 1990s as a mechanism to help the urban and rural poor access loans and hence act to remediate their poverty.

Champasak province is the regional capital of Southern Lao PDR. Compared to other provinces

of the South, Champasak province has succeeded in poverty reduction over the past decade. The percentage of poor people in the province has dropped gradually from 15 percent in 2004 to 5 percent in 2008 (Department of Planning and Investment, 2010). Even so, the poverty rates in Champasak province has remained high in some districts, particularly Munlapamok, Sukuma, and Paksong (Table 3).

Pakse was chosen to represent an advanced area where poverty has been completely eradicated. Bachieng district, on the other hand, is a rural area that still has a high poverty rate. It should be noted that Bachieng district was also among the districts that the government of Lao selected to pioneer the benefits from the National Poverty Eradication Program.

The objective of this paper was to review the development of microfinancing through the VDF in Lao PDR and the implementation of the VDF in Southern Lao PDR, using the VDF in Pakse and Bachieng districts of Champasak province to

**Table 2** People living in poverty in Lao from 1993 to 2010

Year	1993	1998	2002	2005	2009	2010
Percentage	46.0	39.1	33.5	30.7	26.0	26.0

Source: Statistics Department (2011)

**Table 3** Poverty rate in Champasak province, 2010

District	Number of households	Number of poor households	Poverty rate
			%
Pakse	12,798	0	0
Sanasomboun	12,476	150	1.2
Phonthong	15,545	369	2.3
Bachieng	9,118	502	5.5
Paksong	12,195	3,112	25.51
Pathumphone	9,771	1,100	11.25
Champasak	9,980	450	4.5
Sukuma	8,545	2,757	32.26
Munlapamok	5,507	942	17.1
Khong	14,389	39	0.27

Source: Calculated from raw data of Office of Political and Rural Development (2010)

compare VDF outcomes in an urban and rural area, respectively.

Using descriptive analysis, this paper will first summarize the finance sector and the village development fund in Lao PDR. Then, the management and administration structure of the VDF are discussed. Observations on management performance are then described. The paper concludes with general recommendations.

Data from the VDF in the two districts (Pakse 41 and Bachieng 39) and the information about the operation and management of the VDF for 2010 from interviews with the heads of the VDF in the two districts were used to describe the operation and the performance of the VDF.

## RESULTS AND DISCUSSION

### Lao financial sector

After Independence Day 1975, the financial sector in Lao PDR was weak and existed only in urban areas. People living in rural areas had to rely on an informal financial sector for agricultural or non-agricultural loans. During the 1980s, the banks, as a financial mechanism, were centrally planned, administered, and subsidized from the central to the local level. During this period, the banks also had very limited resources, and loans were restricted to support only state factories, enterprises, farms, and cooperatives. Very limited funds were provided to the private sector or individuals.

Since the early 1990s up until the present, the market-oriented policies of the Lao government have resulted in a substantial change to the financial

sector. The central bank—the Bank of Lao PDR (BOL)—has gradually played an increasing role in macroeconomics to safeguard the foreign reserves of the government, to regulate the printing of currency and to reform bank branches in Lao and restructure the state-owned banks. The BOL is also responsible for drafting the financial sector strategies to focus on macroeconomic stability and the regulatory framework overseeing the provision of financial services from the state to market forces and general monitoring (Keomanisy, 2003).

### Formal sector

The BOL is in charge of the financial sector in Lao PDR and works as the supervisor and regulator of the public and private banks in the country. In 2010, there were four state-owned commercial banks compared to 11 foreign bank branches (including the Bangkok Bank, Krungthai Bank, and Sacom Bank among others) and domestic private banks (Table 4). The private and foreign banks are concentrated mainly in the non-agricultural and urban areas and thus play a limited role in supporting the poor people. The development of a formal financial sector in Lao PDR is still slow, particularly with regard to support for the agricultural sector. This has been due mainly to the relatively low business attractiveness of the sector. It is also partly due to the lack of effective collateral on the part of the farm households.

The only state-owned bank that is directly linked to rural households is the Agriculture Promotion Bank. Its branches have been established in most districts to serve the agricultural sector and

**Table 4** Banks in Lao PDR, 2009

Category	Number of banks
State owned commercial bank	4
Joint venture bank	2
Foreign bank branch	11
Private bank	8

Source: Bank of the Lao PDR (2010)

farmers in rural areas. In 2007, the Lao government set up the Policy Bank to enhance financial access to the poor people living in the 47 poorest districts of Lao PDR. The Policy Bank only provides loans to support the agricultural production of specific farmers' groups (Latsavong & Biallas, 2007).

### **Semi-formal sector**

The semi-formal financial sector is allowed to provide limited financial services, such as loans, but not deposit or savings accounts. This semi-formal sector is operated mostly by non-government organizations with specific objectives under different projects or programs. The funds are usually provided by an international development cooperation. The operation is normally limited to certain areas with specific project periods. This semi-formal financial sector was established in 2004 in three provinces of Lao PDR—namely Vientiane, Luang Prabang, and Savannakhet—and supported by the Asian Development Bank and others such as the French International Development Agency to support the commercial capacity building of coffee growers on the Bolaven plateau. The United Nations Development Programme supports the government of Lao through the UN Development Assistance Framework and the government's National Socio-Economic Development Plan.

### **Informal sector**

This sector contains the most important financial sources for poor urban and rural households. The operators range from money lenders to shop owners or traders. They provide all services as they are needed, especially loans or deposits. Nevertheless, the loan service is probably the most important activity of this informal financial sector.

Poor and low income households are normally not served by formal financial institutions because these households are considered to be high risk, with high costs and low profitability. These

particular groups also lack the collateral required by formal financial institutions. Hence, the poor and low income households have to rely on informal sources of microfinance.

According to the World Bank, there are several strong micro financial institutions that are performing well in several countries such as the Grameen Bank in Bangladesh, the Bank Rakyat Indonesia and Bancosol in Bolivia; in 2005, microfinancing in South Asia covered at least 35 million of some 270 million families and contributed about 15 percent of overall credit to low income families based on different models (World Bank, 2006). For example, the Grameen model uses no formal documents and accounts are maintained under the individual names of clients. The "Self-Help Group" operation of the 15–25 members is based on the principle of the revolving use of the members' own savings. Cooperative programs provide financial services by microfinance to individual clients organized into credit and saving cooperatives. A mixed model using both the Grameen model and the Self-Help Group model can be used depending on market conditions. The Rural Support Program is based on establishing and strengthening village organization (World Bank, 2006).

In Vietnam, microfinance was observed as an important tool for poverty reduction (Nghiem, Coelli, & Rao, 2006). In Thailand, the government injected nearly USD 2,000 million as village funds to villages and communities across the country and it became one of the main sources of funding to villagers and community members to enhance their agricultural or non-agricultural investments (Wattanakuljarus, 2008).

In Lao PDR, the informal financial sector has existed since Independence Day in the form of cooperatives and after that the Lao government policy replaced them with the VDF.

The VDF was set up nationwide in 1997 as part of the government policy to provide financial services to the poor. The fund aimed at enhancing

income generating activities and contributing to poverty alleviation. Within slightly more than a decade, there were more than 3,300 instances of VDF with more than 334,000 households as members and nearly one-half of the establishments in the Central region (Table 5). The VDF is the largest informal financial sector in Lao PDR.

The VDF system in Lao PDR provides a small-scale source of funding. In principle, it is set up by villagers and is made up of members' properties and assets, which may either be in the form of cash or produce (rice, animals, or other products). Members contribute to the fund based on their own capacity to contribute, either on an individual, voluntary basis or through a collective agreement amongst several villagers to form a collective fund. In addition, this fund is also aimed at providing small-scale financial services, such as small-scale banking (credit and deposit facilities), which are intended to be accessible to members and provide them with a source of cash and capital to run their own businesses.

**Specifically, the reasons behind the establishment of the VDF are:**

(i) To establish a resource of revolving funds within the villages to provide either credit or savings to its members, which will be used to establish income generating activities in times of an emergency or as a response to a particular situation in the villages;

(ii) To support and build the capacity of the villages in terms of the financial resource management system, in accordance with the local situation;

(iii) To develop self-reliance in terms of learning, using one's own initiative to address problems and to encourage, strengthen, and expand the local economy;

(iv) To ensure villagers actively participate as key elements in strengthening the socio-economic situation of their villages;

(v) To safeguard the local environment, culture, and traditions for the future.

In order to strengthen local management capacity, local people must take part and participate in determining the future direction and management of their own villages by using their own existing knowledge and resources, with technical support from the relevant authorities. This participatory approach is also intended to nurture solidarity and assistance amongst villagers, particularly amongst the poorest group. The rules and regulations of the VDF have been improved to ensure better control of funds over time.

To be able to efficiently manage and make use of the VDF in a sustainable manner, some important principles must be applied (Darachantra, 2003):

(i) Villagers make their own choices or plans and implement the VDF independently; the local government authorities should provide consultation and advice on technical issues only;

(ii) The development fund is a fund to provide credit or mobilize savings for its members only. Members must also abide by the rules and regulations of the VDF and the amount borrowed must be repaid back into the VDF with interest within an agreed period as stated in the loan contract.

**Table 5** Village development fund in Lao PDR, by region as at 2009

No	Region	Number of village development funds Establishment (fund)	Number of member
			(persons)
1	Northern	914	57,198
2	Central	1,603	208,901
3	Southern	797	68,522
	Total	3,314	334,621

Source: National Economic Research Institute and German International Cooperation (2011)

(iii) The VDF members will receive dividends according to their shares and members who deposit savings into the VDF will receive interest according to the VDF rules and procedures.

It should also be noted that the existence of the VDF is also part of the criteria for a village to be classified as a development village or be a member of a cluster of development villages. This condition induces the villages to establish the VDF and ensure its ongoing existence.

Following Decree No. 90 of the Prime Minister of Lao PDR (Central Party Committee, 2003), regarding the development of villages and groups of villages in Lao PDR and according to the policy of the Governor of Champasak province (Governor of Champasak Province, 2011) to promote financial accessibility to rural households, the first VDF in Champasak province was set up in 2000 in 10 villages of Phonethong district with LAK 4 million (LAK = Lao PDR currency, the kip; USD 1 = 7,483 kip) (Figure 2). Since then, the VDF has been established across the province and in gradually increasing numbers. The number of funds had reached more than 370 in 2009 (Table 6).

Following the general principles, the VDF in Champasak province has the role to promote saving

and provide a credit facility to its members. The fund normally requires a minimum saving of not less than LAK 5,000 per month from each member. Failure to continue saving for three months will result in the loss of membership from the VDF.

Members with savings of not less than 3 months can apply for credit of not more than five times the amount of money they have already deposited in the fund. The period of loan ranges from 3 to 6 months with interest rates between 2 and 5 percent per month. Borrowers are subject to payment of interest every month and repayment of the capital at the end of the lending period.

#### Management and administrative structure of village development fund

The management and administrative structure of the VDF is generally the same throughout Lao PDR. Figure 1 shows the structure of the VDF in Champasak province. Similar to the cooperative concept, the VDF is governed by its members. The members elect the management committee and its advisory committee. The management committee is normally composed of 3–5 members responsible in five areas of work, as shown in Figure 1. The provincial authorities play a

**Table 6** Establishment of village development fund in Champasak province, Lao PDR, 2001–2009

District	Year					Total (number of funds)
	2001–2005	2006	2007	2008	2009	
Pakse	8	7	10	11	6	42
Sanasomboun	3	6	8	10	5	32
Bachieng	14	5	8	7	5	39
Paksong	3	4	7	7	5	26
Pathumphone	5	13	10	9	5	42
Phonethong	38	7	9	10	7	71
Champasak	1	5	8	9	7	30
Soukhouma	6	3	3	4	3	19
Moun	2	4	5	4	2	17
Khong	6	13	12	15	8	54
Total	86	67	80	86	53	372

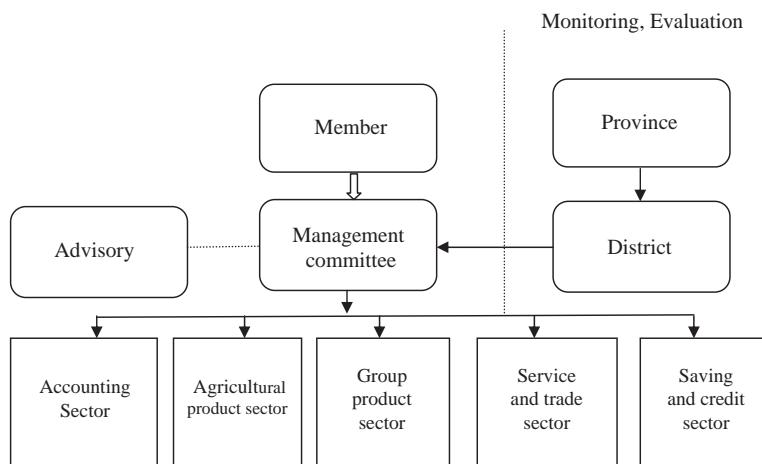
Source: Office of Political and Rural Development (2010)

monitoring and evaluation role at the district and provincial levels. Hence, management of each VDF is overseen by the members. This is quite important in terms of the efficiency and sustainability of the fund. The members must realize their roles and then effectively participate in the development of the fund. Knowledge and understanding of the principles of the fund by the members are crucial.

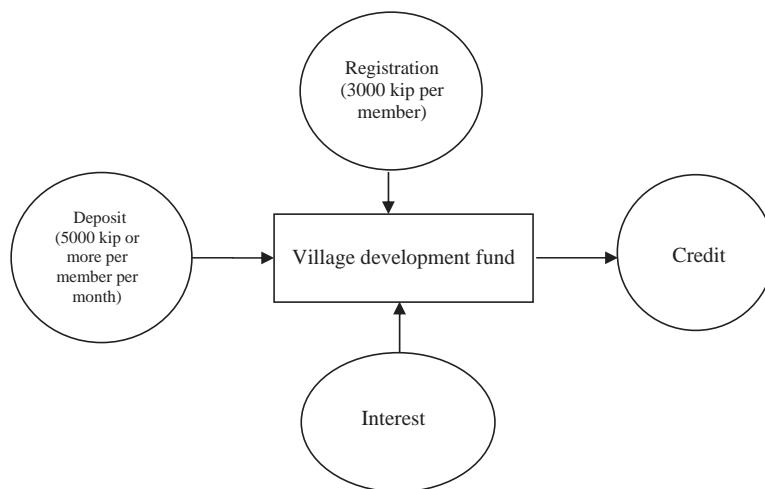
There are three sources of funds available to the VDF. The most important source of funds is the compulsory monthly deposits from its members.

The other two sources are the registration fee and income from interest (Figure 2). Notably, in a few villages, farmers are charged for water fees and the income is given to the VDF.

As of 2010, 429 villages in Champasak province had established a VDF fund with total funds amounting to about LAK 25 billion or about LAK 58 million per village (Table 7). Partly due to the rules and procedures, the number of members saving with the fund was larger than those members receiving loans.



**Figure 1** Structure of village development fund in Champasak province, Lao PDR



**Figure 2** Flow of funds into village development fund in Champasak province (USD 1 = 7,483 kip).

**Table 7** Number of members and amount of savings and loans of the village development fund by district in Champasak province, 2010

Name of district	Village (number)	Member savings (persons)	Total savings (million kip)	Members borrowing (persons)	Total loan (million kip)
Pakse	42	8,400	9,890.55	4,665	9,853.97
Sanasomboun	45	3,302	928.60	1,104	860.50
Phonethong	50	8,186	7,526.45	2,469	7,274.96
Bachieng	39	4,291	918.76	1,954	903.96
Paksong	52	2,612	334.923	2,326	331.00
Pathumphone	56	4,229	1,286.35	3,686	1,279.30
Champasak	24	777	382.34	249	380.00
Sukuma	34	1,196	138.53	709	135.40
Munlapamok	25	1,449	481.73	282	460.25
Khong	62	7,260	3,248.56	1,461	3,109.63
Total	429	41,702	25,136.81	18,905	24,588.97

Source: Office of Political and Rural Development (2010)

USD 1 = 8,075.57 kip, as of 2010

Comparing districts, it is notable that the amount of funds in the capital district (Pakse district) and districts bordering neighboring countries (Phonethong and Khong districts) are relatively large. This is due mainly to the concentration of the economic activities in these areas, especially associated with domestic and border trade. The funds in other districts are relatively small due to the relatively weak and limited economic activity which is mainly based on agriculture as these areas are also poor in terms of basic infrastructure and social services.

#### Some observations on village development funds in Champasak province

As can be seen from the discussion above, the VDF in Lao PDR in general and in Champasak province in particular is very much dependent on the participation of the members and the management capabilities of the committee members. This section discusses some characteristics of the key players of the VDF process in Champasak province that are related to the management and operational efficiency of the fund. Information was obtained from

interviews of the village development fund management committees in two districts. In Pakse district, there are 42 villages and it is the most advanced urban district in Champasak province with a poverty rate of zero. Bachieng is one of the 47 poorest districts in the country that has succeeded in reducing its poverty rate among the rural districts—39 villages from this district were used in the study.

#### Management committee

The government has facilitated the establishment of the VDF through training and technical support to village leaders. Following the principles described above, the village leaders are responsible for consulting the village members and agreeing on the rules and regulations of their own village fund. The training generally lasts for one or two days for the preparation of the establishment of the fund. General guidelines for the management and operation of the fund are provided. An annual meeting to assess the development and exchange experiences between members of the VDF management committees and the provincial officials is also organized. Under the government's self-reliance

policy, the VDF is expected to be able to operate profitably and sustainably. The opinions from the headmen of the VDF in Pakse and Bachieng are shown in Table 8.

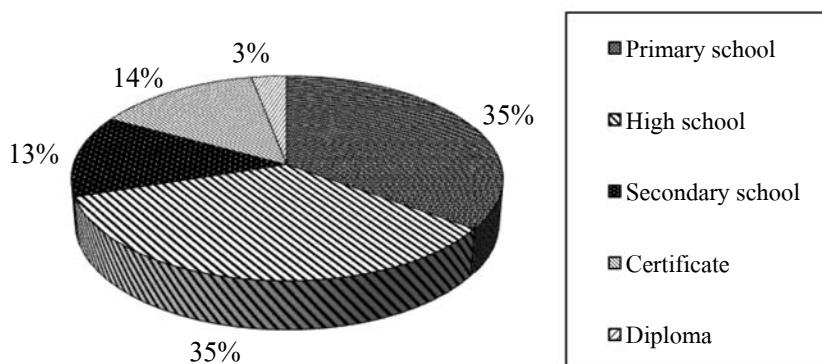
Probably one of the most important key organizations in the VDF process in Lao PDR is the village development fund committee. The committee is composed of 3–10 members elected from the village fund members.

As shown in Figure 3, about one-half of the committee members had either primary or secondary education. It is also notable that more than one-third of them finished high school. This suggests that the committee members do have a good basic education. Their capacities could be enhanced effectively through sufficient and proper training. The interview with the village development fund committees also did not identify technical constraints. Only about 10

**Table 8** Opinion of headmen of the village development fund in Pakse and Bachieng

Item	Number of funds			Percentage of total VDF		
	Pakse	Bachieng	Total	Pakse	Bachieng	Total
Lack of knowledge and understanding among members	6	1	7	14.28	2.56	8.64
Lack of knowledge among committee	2	0	2	4.76	0.00	2.46
Poor performance of the committee	2	6	8	4.76	15.38	9.87
Complicated procedures for loan application	2	0	2	2.38	0.00	4.76
Poor enforcement of rules/regulations on loan	6	0	6	14.28	0.00	7.41
Members didn't follow the rules	24	11	35	57.14	28.20	43.21
Insufficient funds	4	1	5	9.52	2.56	6.17
Poor performance of the fund	5	2	7	11.90	5.12	8.64
Low deposit rate from members	6	0	6	14.28	0.00	7.41
Lack of transparency	1	0	1	2.38	0.00	1.23
No participation from rich farmers	1	0	1	2.38	0.00	1.23

Note: The percentage in each column refers to the percentage of total VDF by district and total.



**Figure 3** Education level of village development fund committee members in Pakse and Bachieng districts in 2010

percent of the management committee members lacked knowledge of or responsibility in management.

### Management of the fund

As the VDF is solely managed by villagers whose financial management knowledge is very limited, its operation is critically dependent on the capacity enhancement programs of the public sector in the initial stage and on the participation of the stakeholders. This is especially true for financial management as there must be a knowledge of basic accounting and record keeping systems. The different types of training provided to the management committees are important tools of the government to enhance the management's operational capacity.

Figure 4 shows that about one-half of the training offered was on accounting systems, one-quarter was given to credit issues and another one-fifth devoted to the general concept of rural finance. It could be said that by subject, the training generally corresponded to the technical needs. Nevertheless, it is equally important to emphasize the ethical perspectives and good governance concepts to ensure the transparency and accountability of the system are well in place. As shown in Table 8, several problems were related to the management of the fund, with the most critical one being the lack of compliance to the rules and regulations by the members. More than 43 percent

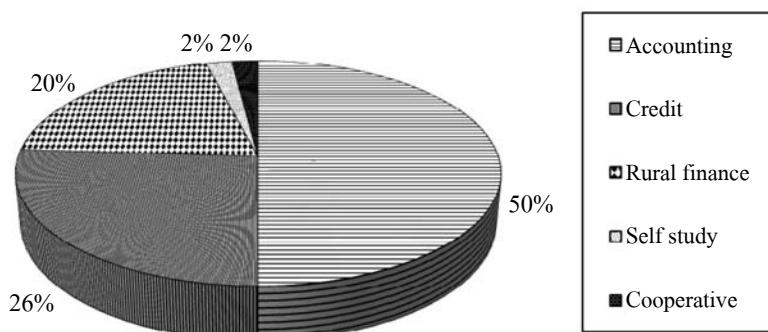
of the respondents indicated this was a problem. In Pakse, personal privilege and a lack of transparency were the key drivers of the problem.

The experiences of the members in the VDF in Champasak province suggest that the training subjects generally covered the technical needs of the management. The issues that needed to be addressed focused more on the principles of the fund and ethical aspects and good governance as well as time allocated to the training, including exercises or practice. The development of a curriculum on those aspects to enhance management capability should be considered.

### Operation of the fund

The operation of the fund is an important factor contributing to efficient fund management. The mobilization of funds, the costs and returns associated with providing deposits and loans and the turn-over period of the funds are critical to development.

The operation of the fund varied among villages. Basically, deposits and credits were made at a specific time each month, lasting from one to three days depending on the size of the fund, and the period could be either at the beginning or the end of the month. The office location of the village funds also varied among villages, with some being in the house of the village headman, others in community centers or temples.



**Figure 4** Types of training given to village development fund management committee members in Pakse and Bachieng districts in 2010

As a general rule, the members are obliged to save monthly, for a minimum of three consecutive months. The credit ceiling is subject to the amount saved with the fund. The loan periods and the interest rates are agreed by the members, within the ranges allowed by the government (between 2–5% per month). For example, the interest rate charged in Huayangkham village was 5 percent per month, compared to that of Nonsay village of 2 percent per month. The differences generally reflected the demand and supply of funds and partly reflected the opportunity costs of investment in the villages. However, it was surprising to observe that loans for emergency cases were charged at lower rates than income-generating loans. This reflects the effects of social ties within the rural communities in Lao PDR.

The interest earned by deposits made to the fund depended on the profit of the operation of the fund. At the end of each year, 70 percent of the income would be returned to the members as interest earned from the deposits. Hence, the interest rate for deposits varied from year to year. Nevertheless, in general, the members expected the interest rate for deposits made to the VDF to be higher than that of commercial banks (about 12% per year). According to the villagers, this village fund operation system enhances the household practices to monitor not only the performance of the VDF but also their own financial management, especially consumption and saving behaviors.

The policy on loan periods also varied with different villages. Normally, the loan period for business was shorter than that for agricultural production activities; this was reflected by the shorter loan periods in villages in urban areas of Pakse district compared to those of Bachieng district. For example, a loan for purchasing passenger tricycles or bamboo processing or pig farming in Pakse district was only for 3–4 months while loans for agricultural or non-agricultural activities in Bachieng districts were for between 4 and 6 months. The loan period affects the rate of turnover and

hence the profitability of the funds. Nevertheless, the loan period for agriculture has to allow for sufficient time for farmers to generate a return. Thus, by the nature of this activity, loans provided to agriculture tended to be higher risk than in non-agriculture. Partly due to the risk perception and in order to ensure management performance, it was observed that many village funds restrict loans only to the first half of the year.

Not only income generating activities are supported by the VDFs; certain consumption needs, especially for education and health are also supported. While agriculture and business cover about three-quarters of the use of funds, education and health constitute the remaining one-quarter.

There were no specific comments related to the operation of the fund by the fund personnel. As shown in Table 8, a few responses referred to complicated procedures, the low interest rate for saving deposits, and the small amount of funds.

In summary, the operation of the fund was generally similar among villages, although certain differences in interest rates charged and loan periods could be observed. Most loans were given to income-generating activities, although some were provided for consumption needs. The deposit rate of interest was practically determined by the performance of the VDF. Hence, rates of interest for loans and repayment rates are important factors in this regard.

### Performance of the fund

In general, the financial performance is reflected by the profit generated to the investor. With the multiple objectives of the VDF, the performance of the fund is influenced to the largest extent by the general guidelines provided by the provincial authority. It is notable that the VDF in Lao PDR, including Champasak province, is required to contribute to village development, including the maintenance of temples, improvement of schools, and the maintenance of public infrastructure or utilities like roads or the health centers of the villages.

As the operation cost is minimal, income from the VDF is used as the basis for distribution. There was no specific regulation for income distribution of the VDF, although a suggested distribution in general was that 70 percent should be returned to the shareholders, 20 percent to the management and advisory committees and the remaining 10 percent was allocated to the operation of the fund and the social development of the village (Table 9).

Different villages, based on the suggested guidelines in Table 9, determined their own distribution of funds, depending on the structure and environment. For example in Sanamxay village of Pakse district, they provided a slightly lower share to the management and advisory committee and a higher share to social development, as well as a small share for capacity building activities (Table 10).

The repayment rate of loans is a key factor in income generation from the VDF. About 20 percent of village funds in Pakse had difficulties in loan repayment while the problems in Bachieng were relatively less. Notably, in many cases, the

non-performing loans were caused by failures resulting from crops or livestock raising.

The ability to collect loan repayments for the VDF was unique to each village. It was also observed that a close relationship among village members can induce positive or negative effects on repayment rates. In certain villages, senior and respected managers tended to be able to chase up loan repayments. On the other hand, managers tended to fail when the recalcitrant customers had a close relationship with them and were more senior than they were. This is also reflected by the views expressed in Table 8. In general, it can be said that the social structure in the villages could also positively or negatively affect the performance of the management of the VDF.

## CONCLUSION AND RECOMMENDATIONS

The village development fund was set up by the Lao government as a supporting tool for poverty

**Table 9** General guidelines for distribution of income of village development fund

Category	Share of total income (%)
Return to the share holders	70
Compensation to the management committee	15
Compensation to the advisory committee	5
Reserves	5
Social development of the village	5

Source: Office of Political and Rural Development (2005)

**Table 10** Distribution of income from village development fund in Sanamxay village

Category	Share of total income (%)
Return to the share holders	65
Compensation to the management committee	12
Compensation to the advisory committee	5
Reserves	3
Social development of the village	10
Study tour	3
District advisor	2

eradication in the country. In principle, the fund hopes to utilize the wages income or earnings within the villages to develop a self-evolving fund to foster village development. The village development fund is generally guided by common rules and procedures. Strong public support has been provided through training, monitoring, and evaluation by public agencies. The performance of the fund is dependent primarily upon the capacity of the villages themselves.

Champasak province had been regarded as one of the poorest provinces in the southern part of the country. With increased utilization of the rich natural resources and the strong commitment of the public sector, the poverty level in the province has declined satisfactorily. The village development fund of the province has also been developed well. This study reviewed the overall development and highlighted some problems encountered by two districts in the province—namely the advanced urban district of Pakse and the rural district of Bachieng.

The organizational structure of the village development fund was the same in general in both districts with similar management and operation guidelines provided by the authorities.

Development of the village development fund in Champasak province was largely dependent on the commitment of the management and advisory committees. With good education, potential capacity development is high. The public sector also regularly provides technical supports to the villages. However, management problems were mostly induced by personal relationships or social cohesion within the villages. When members ignored the rules, management was reluctant to enforce them. The performance of the village development fund was generally satisfactory. Surprisingly, relatively more village funds in the advanced urban district of Pakse had problems related to non-performing loans than in the rural district of Bachieng. Notably, the problems were due to business failures not the misuse of loans. It should also be noted that all village development funds are required to contribute

certain benefits to the social development of the villages.

The special characteristics of the village development fund in Lao PDR require certain contributions to village development and a flexible return to the shareholders as the interest earned on saving deposits needs to be based on a good balance between economic and social incentives to the stakeholders. The observations of the village development fund in Champasak province and the views from members and officials in selected village development funds indicate that it is important to widen the capacity development by more campaigning to develop the basic knowledge of principles and concepts among the members and by promoting ethical development and good governance among members of the management and advisory committees. To avoid non-performance of loans, it is essential to reduce risks from investment in agricultural or non-agricultural activities. This requires more support from the public sector to ensure the efficiency and sustainability of the village development fund.

## REFERENCES

Bank of the Lao PDR. (2010). *Annual economic report 2010*. Vientiane, Lao PDR. Retrieved from <http://www.bol.gov.la>.

Central Party Committee. (2003). *The establishment of “Kum Ban” (Cluster of Villages) into a regulation of the government; Develop an implementation plan to support the organization of “Kum Ban”*. Vientiane: Government of Lao.

Committee for Planning and Co-operation. (2003). *The Lao PDR’s national poverty eradication programmed – a comprehensive approach to growth with equity*. Vientiane, Lao PDR.

Darachantra, S. (2003, June-December). Microfinance capacity building and research project. *Microfinance Newsletter Issue 1*.

Department of Planning and Investment. (2010). *Investment opportunities in Laos Champasak*

province. Champasak, Lao PDR.

Foundation for Development Cooperation. (2010). Microfinance industry report. *Lao Peoples Democratic Republic*. Queensland, Australia.

Governor of Champasak Province. (2011). *The implementation and management of microfinance in Champasak province*. Lao PDR.

Keomanisy, V. (2003). *Background and evolution of the Bank of Lao PDR since its establishment to date*. Retrieved from <http://www.bol.gov.la>

Latsavong, L., & Biallas, O. (2007). *Lao PDR financial sector diagnostic international finance corporations*. Washington, DC: International Finance Corporation, World Bank Group.

Ministry of Planning and Investment. (2011). *The Document of the Seventh National Socio-Economic Development Plan (2011-2015)*. Vientiane: Government of Lao PDR.

National Economic Research Institute and German International Cooperation. (2011). *Microfinance in the Lao PDR, 2009*. Bonn and Eschborn, Germany: Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH.

Nghiem, H., Coelli, T., & Rao, D. S. P. (2006). The efficiency of microfinance in Vietnam: Evidence from NGO schemes in the north and the central regions. *International Journal of Environmental, Cultural, Economic and Social Sustainability*, 2(5), 71-78.

Office of Political and Rural Development. (2005). *General guidelines about rules and regulations of village development fund*. Champasak, Lao PDR.

Office of Political and Rural Development. (2010). *The operation and implementation of microfinance in Champasak province*. Office of Political and Rural Development Champasak province, Lao PDR.

Statistic Department. (2011). *Report 2010*. Vientiane, Lao PDR: Ministry of Planning and Investment.

Wattanakuljrus, A. (2008). Thailand village fund: Populist policy for the poor. *NIDA Case Research Journal*, 1(1), 42-92.

World Bank. (2006). *Microfinance in South Asia: Toward financial inclusion for the poor*. Washington, DC: The World Bank.