POLICY BRIEF

Household responses to access to finance through GIZ-Access to Finance for the Poor (AFP) Village Banks

SUMMARY

During late 2015, an evaluative study was conducted of household response to changes in access to finance resulting from village banks established by the Access to Finance for the Poor (AFP) program. The program was commissioned by the German Federal Ministry for Economic Cooperation and Development (BMZ, co-financed by the Australian Department of Foreign Affairs and Trade (DFAT) and Minerals and Metals Group Lane Xang Minerals Limited (MMG LXML) and implemented by GIZ. The study, conducted by the Laos Australia Development Learning Facility and GIZ, found that households respond to village banks by increasing their savings rate; making use of credit for emergencies; consumption smoothing and enterprise development; and feeling more confident and in control of their future. Households used access to a village bank as part of their resilience strategy – saving for an uncertain future and using emergency loans – a contribution these banks make to social protection. The study concluded that village banks are a replicable and scalable model for providing access to finance, and that they support women's economic empowerment by enabling enterprise development and supporting women in governance roles. The study identified opportunities to strengthen financial literacy, improve the business enabling environment, and build the capacity of network service organisations (NSOs) to support village banks.

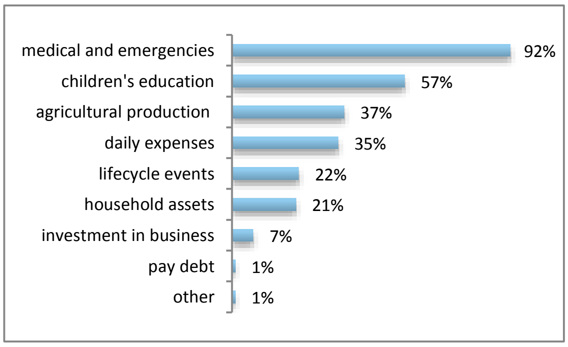
KEY FINDINGS

This study found that households respond to having access to financial services through an AFP-supported village bank by:

- **Saving more** – having a safe place to keep their savings with a competitive return causes member households to save more. Increased savings rates (79% before joining the village bank compared to 100% after) despite low and inconsistent incomes, suggests an improvement in financial literacy and management, which both contribute to a sense of wellbeing and confidence. Some respondents – the better off or those receiving remittances – used commercial banks as well, but they preferred the village bank because of its convenience and competitive dividend payment on deposits. Respondents also perceived the village bank to be reliable, trustworthy, and transparent as well as having better management systems compared with village funds they had participated in previously.

Village bank committee registering saving passbooks

Respondents' use of savings



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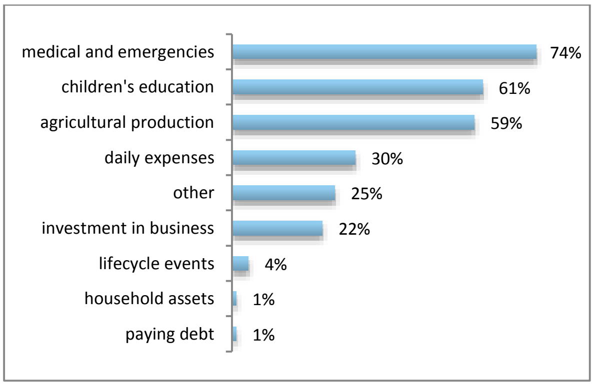
- **Using credit** – improved physical, cultural and administrative accessibility of loans offered by the village bank increased the confidence of households to use credit. Membership of the village bank did not dramatically increase the tendency to borrow (the percentage of quantitative survey respondents that had borrowed before and after joining the village bank only increased by 3%: from 67 to 70%). But it did change the ***source of loans*** away from local money lenders charging up to 15% per month in interest (43% before to 25% after), cash strapped family and friends (29% before to 11% after) to village banks (0% before to 66% after).

  Credit is increasingly being used for trading and productive purposes – suggesting entrepreneurial capacity is encouraged by village banks. Village bank membership also provides access to credit for women who would normally be reluctant to enter a commercial bank to seek a loan. As members become more confident and demand larger-scale loans for enterprise, the NSOs and commercial banks become more competitive and those members use a blend of financial service providers. This graduation in economic activity enables trade and economic growth.

Respondents' use of loans



- **Using health and education services** – village bank members use village bank savings and credit services to fund health care, education, consumption smoothing, and "lifecycle events" such as weddings or funerals. Village banks support households to educate their children, through both mandatory and voluntary monthly savings which over a number of years can build up to amounts sufficient to fund secondary education.
- **Developing private enterprises** – access to village bank financial services helps households manage agricultural production and invest in trading or production enterprises. Cash poor households use production loans to fund agricultural inputs (*e.g*. seeds, fertiliser, equipment hire or labour) before receipt of harvest income. Village bank trading loans help others establish and operate small retail and service enterprises.
- **Becoming more engaged** – having a strong sense of ownership in the village bank enables households to engage with institutional and other opportunities in the village. Democratic elections of village bank committees, participatory management systems and good governance, coupled with financial literacy training, give households exposure to practices relevant to village meetings, local development planning and enterprise management. Positive discrimination for women as members of village bank committees (*e.g*. women are often elected to the positions responsible for keeping the village bank account books) benefits the elected individuals but also the standing of women in the village.
- **Recognising a role for women** – this study also found that women have an accepted role in managing household finances (*e.g*. 74% of respondents said that men and women in their household make financial decisions jointly) which is enhanced by village bank governance requirements. Village bank membership increases household financial transparency which benefits women and other family members.
- **Feeling more secure** – the availability of emergency loans, especially for health crises, provides village bank members with peace of mind and is a significant boost to a feeling of wellbeing and security.

Respondents to this study said village bank loans do not lead to unsustainable indebtedness. Out of those who had borrowed, 96% said they fully understood their loan obligations and 100% said when they took out the loan they were certain having enough money to repay it. 87% had successfully repaid at least one loan and only 3% said they had to sell an assets to pay back their loan. Particularly in locations closer to district centres, households use multiple income streams such as sale of agricultural produce and income from trading and day-labour to manage loan repayment obligations. Households in remote locations are more reliant on the sale of agriculture produce for income. Interpersonal connections between households (e.g. village bank members and their income circumstances are known to the village bank committee), social obligations and a sense of ownership in the village bank encourage timely repayment, as evidenced by the low portfolio at risk ratios in the village banks studied which is below the international benchmark of 5%.

The study also identified that limits to the amount of credit available can be a constraint in the village bank model, especially during the early years of their establishment. As funds for loans are sourced from members' savings, those banks that have existed for a short time or have predominantly poor members have small balances available for lending. The AFP program does have a system of wholesale loans from NSOs, which on-lend funds from those village banks with excess liquidity to village banks needing additional capital. The NSOs are servicing all village banks on a monthly basis and collect detailed transaction data on individual client level. By analysing the clients' activity rate, the credit morale and other aspects the NSOs are enabled to assess potential risks for their lending decisions. The wholesale credit ceiling for each village bank depends on the individual risk assessment but can in no case exceed the value of the village bank's savings. The extent to which village banks can rapidly scale investment depends on the savings contributions of members. Among new village banks, particularly in poorer areas, it can be difficult to scale quickly.

Some households use village bank credit to pay for agricultural inputs; others managed cash flow by using savings at the beginning of agricultural season and returning surplus to savings after harvest.

CONCLUSIONS

This study of household response to changes in access to finance concluded that:

- **Village banks are a replicable and scalable model for providing access to finance**. The participatory management systems and use of member savings to finance credit creates strong ownership among members. The use of NSOs to provide wholesale credit and technical support to village bank committees creates an effective bridge to the formal banking system for relatively poor and remote rural households. Since NSO-staff are not biased by, or dependent on, village social eco-systems they can freely provide independent advice needed to point out, discuss and solve problems. In village funds that are not supported by external agencies problems may remain unsolved and lead to the collapse of those funds.
- **Access to village banks for saving and emergency loans is a form of social protection.** Many village bank members use village bank savings and emergency loans as a strategy to mitigate the risks of illness or emergencies. Offering emergency loans by village banks is a strategic response to the demand for self-reliant social protection mechanisms, particularly in environments without access to formal social protection or affordable insurance services for the poor and vulnerable. Availability of emergency loans provides confidence for some households to invest in small enterprises that contribute to trade and economic growth in a context such as Lao PDR.
- **The community finance model is effective but cannot address all development needs**. The model may not be sufficient for supporting the poorest of the poor. Although the poorest households with insufficient income to make the required minimum monthly savings contribution may be accepted as members with irregular contributions they are – for good reason – excluded from credit services. Many of the poorest choose not to join as they believe they do not have sufficient money to contribute savings. The income group that benefits most from a village bank is the middle and upper poor. For the poorest of the poor a graduation or similar model can help them to bridge the gap and to more

efficiently use the services of a village bank. The model offers less potential for enterprise investment in those villages with savings balances that are too small to finance much credit. Also, the extent to which access to finance benefits villagers depends on what economic opportunities available which is affected in turn by the business enabling environment.

- **Village banks contribute to women's economic empowerment.** Because women have an accepted role in household financial management, village banks and related financial literacy training offer an accessible and convenient means to empower women. Improved access to finance at the village level, and including women on village bank committees, strengthens the capacity of women as household managers, entrepreneurs and carers as well as providing important role models of economically active women for youth to emulate.

- **Village bank outcomes grow over time.** Because the village bank model relies on members' trust and their savings as a foundation for credit, and builds financial literacy through implementation, the longer the village bank exists the greater the resulting outcomes are – more savings, more loans, more enterprise, and more financial literacy. There is an opportunity to use co-location to link village banks with other programs. GIZ has developed pilots such as sanitation/latrine credit, and livelihood credit for MMG's mandarin production groups. There is also potential to use co-location to link village banks with programs such as the Poverty Reduction Fund (for livelihoods responding to new village infrastructure), the District Development Fund (for district economic development) or nutrition programs.

Overall, access to financial services through village banks generated positive responses from respondent households. Opportunities to enhance the response of households to the village banks include supporting improvements to the financial literacy of village bank committee members and village bank members, supporting improvements to the business enabling environment and building the capacity of NSOs to support village banks.

Women play an active role in the village banks, as beneficiaries as well as members of the committee

This report was researched, written and edited by

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